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JURIS

INTERNATIONAL SECURITIES LAW AND REGULATION

Second Edition

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Printed in the United States of America.
ISBN: 978-1-57823-288-8

Juris Publishing, Inc.
71 New Street
Huntington, NY 11743 USA
www.jurispub.com

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Argentina

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Introduction

After a financial and political crisis that developed in December 2001, Argentina enacted a complex and radical monetary change during 2002 that included abandoning the Convertibility Regime (A $1 = US $1) which had prevailed during 1990 to move into an exchange control scheme. Investors were required to structure their business to fit them to the new rules.[1]

Notwithstanding the foregoing, the Argentine securities market continued the transformation in the 1990s. The Executive Branch issued Executive Order Number 677/01, regarding Transparency in the Public Offering for Securities. The Executive Order introduced changes to the former legal framework, including Public Offering Act Number 17,811 and the regulatory framework passed by the National Securities Commission (*Comisión Nacional de Valores*), ie, the New Rules and Regulations Amended Text 2001,[2] adding innovative proceedings and legal institutions to those formerly in existence.

Despite the deep crisis mentioned above, the Argentine Gross Domestic Product experienced an outstanding increase during the 2003–2006 period at an average rate of 8.875 per cent due to certain political and economical decisions taken by the Argentine Government and a favourable international environment for the export of Argentine agro-industrial products and commodities. This re-emerge of the Argentine industry was reflected in its securities market activity, with an increasing amount of new debt securities notes and securitisations.

However, in addition to the Global Financial Crisis in 2008, a deep change in the Argentine Retirement and Pension System seriously affected Argentine capital markets. Pension funds, the major institutional investors in the Argentine market, ceased to exist.

On 20 November 2008, the Argentine Congress posed Law Number 26,425 by which the formerly existing dual Retirement Pension System formed by the private pension funds and the State Administrative Authority (*Administración Nacional de Seguridad Social*, ANSES) has changed into a new single system (the Integrated Argentine Retirement System, SIPA), that eliminates the system of capitalisation. Since their creation, the private pension funds had become the largest institutional investor in the financial and capital markets of Argentina. As of October 2008, the total value of investments made by

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1 The author acknowledges the collaboration of Juan Ignacio Sgaramella.
2 General Resolution Number 368/01.

them amounted to AR $84,816,769,760, of which approximately 56 per cent was invested in transactions of credit for the Argentine state and public bonds. AFJP also was a strong investor in private companies.

Law Number 26,425 provides the terms for the resources which integrate the individual capitalisation accounts of the members of the private capitalisation system of the SIJP, to the traditional administration for social security (ANSES), in order to contribute such amount to the guarantee funds of the Public Pension Regime (*Fondo de Garantía de sustentabilidad del Régimen Previsional Público de Reparto*, FGS). The FGS has the aim of investing surplus in the Public Pension Regime, is managed by the ANSES, and is authorised to make a wide variety of investments. The amendments to the Pension System caused a reduction of the volumes of the transactions made in the capital markets, affecting the value of assets traded thereon and the future issuing of new securities, and a decrease in the demand for securitisation instruments traded in the capital markets, causing a negative impact in the consumer and mortgage credit market.

Regulatory System — Legal Sources

The Argentine legal framework for securities basically consists of Public Offering Act Number 17,811, the National Securities Commission Rules and other regulations passed by the National Securities Commission, the stock exchange rules and regulations mainly based on the Buenos Aires Stock Exchange's (*Bolsa de Comercio de Buenos Aires*) circulars issued by the securities markets (*Mercado de Valores*) adhering to stock exchanges, resolutions of the official registration entity, the *Caja de Valores SA*, and regulations from the *Mercado Abierto Electrónico SA*, the electronic reporting system for trading securities.

From time to time, the Argentine Congress, through the amendment of the Public Offering Act, as well as the enactment of a new Bill, or the Executive Branch by means of an Executive Order, may introduce changes to the Argentine legal framework for securities.

The Executive Branch issued Executive Order Number 677/01, dealing with Transparency in the Securities Market, on 22 May 2001. The goal pursued by Executive Order Number 677/01 is to protect investors as consumers of financial products. Executive Order Number 677/01 sets forth changes to the Public Offering Act as from 1 June 2001. However, two groups of stipulations included in Executive Order Number 677/01 must be distinguished. The first includes self-executive provisions, and the second consists of certain sections requiring the issuance of regulations by the National Securities Commission.

The National Securities Commission issued General Resolution Number 400 and General Resolution Number 401/02 on 5 April 2002, regulating Executive Order Number 677/01. The latter (the 'Public Offer Resolution') specifically deals with public cash offers and public exchange offers describing and regulating public offer bids and procedures. In addition to these regulations, there are certain laws that govern the securities market, directly or indirectly. These include:

- The Commercial Companies Act,[3] governing corporations and other legal entities;

3 Act Number 19,550, as amended.

- The Registered Corporate Securities Act, Act Number 20,643, as amended by Act Number 23,299, which provides that securities issued by private entities in the form of a series must be registered, non-endorsable instruments and that bearer securities must be converted into registered securities;
- The Foreign Investments Act,[4] which establishes the framework for investments made in Argentina by foreign capital or persons;
- The National Securities Commission's Duties and Powers Act,[5] assigning duties to the National Securities Commission for controlling compliance with corporate government requirements by public companies;
- The Bonds Act,[6] providing the requisites for issuing bonds in Argentina;
- The Mutual Funds Act,[7] establishing the legal framework for mutual funds;
- The Integrated Retirement Pension System,[8] establishing requirements for pension funds to invest in the securities market;
- The Trust Act,[9] regulating the creation of trusts;
- The Legislative Powers Delegated to the Executive Branch on Certain Administrative Matters Act,[10] which granted certain powers to the Executive Branch on certain matters originally delegated to Congress by the Constitution;
- The Money Laundering Act;[11] and
- The Leasing Act.[12]

Authorities

National Securities Commission

The National Securities Commission is the principal authority in the securities market. The Public Offering Act provides for the National Securities Commission's authority, duties, and obligations as the controller of the securities market in Argentina. The National Securities Commission is a self-regulated public entity with jurisdiction throughout the country. Currently, the relationship of the National Securities Commission with the Executive Branch is held through the Secretariat of Finance (*Secretaría de Finanzas*) and the Sub-Secretariat of Financial Services (*Subsecretaría de Servicios Financieros*).

The National Securities Commission's functions are carried out by a Board of Directors currently consisting of three members appointed by the Executive Branch, which also appoints the Chairman and Vice Chairman of the Board and two assistant members. Staff

4 Act Number 21,382.
5 Act Number 22,169.
6 Act Number 23,576.
7 Act Number 24,083.
8 Act Number 24,241, as amended by Act Number 26,425.
9 Act Number 24,441.
10 Act Number 25,148.
11 Act Number 25,246.
12 Act Number 25,248.

members are appointed, suspended, and removed by the Board. Any expenses required for the operation of the National Securities Commission are obtained from allowances provided for in the National Budget.

As a result of the enactment of the National Securities Commission's Duties and Powers Act, the National Securities Commission is in charge of controlling compliance with corporate governance requirements of public companies. Closed companies continue to be controlled by the Public Registry of Commerce in Argentina. The National Securities Commission's principal activities consist of:

- Authorising public offerings of securities;
- Advising the Executive Branch on applications for registration submitted by both stock exchanges and securities markets;
- Keeping a record of all issuers authorised to publicly offer their securities and of stockbrokers registered with the securities markets;
- Approving the rules and regulations of stock exchanges and those of securities markets;
- Supervising compliance with applicable laws, rules, and regulations in all matters within the scope of the Public Offering Act;
- Requesting the Executive Branch to revoke the authorisation to function of stock exchanges and securities markets when such institutions have failed to comply with the functions assigned to them and according to the provisions of Executive Order Number 677/01; and
- Declaring irregular and ineffective, for administrative purposes, the acts subject to the National Securities Commission's control when they are against the law, regulations passed by the National Securities Commission, or by-laws.

The National Securities Commission is in charge of issuing the rules to be complied with by natural persons or legal entities when making a public offering of their securities. In exercising these functions, the National Securities Commission may:

- Require reports and carry out inspections and investigations;
- Request the assistance of law enforcement agents; and
- Report crimes or prosecute in court.

In addition, the National Securities Commission is in charge of determining the application of penalties set forth in the Public Offering Act. According to amendments introduced by Executive Order Number 677/01, individuals and legal entities violating the provisions of the Public Offering Act and the regulations thereof will be subject to the following penalties, without prejudice to the applicable civil or criminal actions:

- Warning;
- Fines, ranging from A $1,000 to A $1.5 million, which may be increased up to five times the amount of the obtained benefit or the damage suffered as a consequence of the illegal action, should any of them be higher than the established fine;

- Suspension of up to five years to act as directors, managers, auditors, members of the supervisory council, members of the qualification council, public accountants that have given their professional opinion, external auditors, or managers of issuers authorised to publicly offer their securities, or to act as such in investment or depository companies of mutual funds and in rating agencies or in companies developing the activity of financial trustees, or to act as intermediaries in the public offering or in any other manner which may be under the control of the National Securities Commission;
- Suspension of up to two years from publicly offering securities or of the authorisation to act in the public offering;[13] and
- Prohibition from publicly offering securities or to act in the public offering of securities, forward contracts, futures, or options of whatsoever nature.

In the case of legal entities, the following individuals shall be deemed jointly and severally liable:

- The directors;
- The administrators;
- The auditors;
- The members of the supervisory board; and
- The managers and members of the qualification board.

When a systematic risk practice, or any other serious financial threat, is identified, the National Securities Commission, or the respective self-regulated entity, may suspend the public offering or the negotiation of securities. When the suspension affects self-regulated entities, stock exchanges, or securities markets, the National Securities Commission decision may be extended for a maximum of 30 days, except when the suspension is extended by the Executive Branch.

Sections 14 and 15 of the Public Offering Act, as amended by Executive Order Number 677/01, set forth the proceedings for appealing the National Securities Commission's final decisions imposing any penalty cited above. Any penalty other than fines, the statute of limitations of which is three years, will be extinguished six years as from the prohibited act.

Stock Exchanges

According to the Public Offering Act, stock exchanges must be incorporated as non-profit organisations or as corporations. Stock exchange regulations must stipulate the cases and the conditions under which such institutions secure that performance of their transactions is carried out. Stock exchanges may organise clearinghouses to settle transactions.

Stock exchanges intending to list securities for public trading must obtain prior authorisation to act as such from the Executive Branch through the National Securities

13 In the case of mutual funds, they may only perform administration acts and act, on request, for purposes of repurchasing quotas, being able to sell for that purpose the assets in the portfolio controlled by the National Securities Commission.

Commission, notwithstanding any other requirement set forth by other national or provincial bodies. Stock exchange rules and regulations must provide, for the purpose of listing securities, for matters concerning:

- Authorisation, suspension, and cancellation of the listing of securities;
- Requirements to list securities while the relevant authorisation remains in effect;
- Compliance with existing laws and regulations by listed corporations;
- Rules and measures necessary to ensure the accuracy of the financial statements and other reporting documentation that listed corporations are to file or publish; and
- Issuance of regulations ensuring the accuracy of recorded listings and the publication of such listings and their current prices.

Any security to be listed for public offering and traded on a stock exchange must be previously authorised by the National Securities Commission. The stock exchanges quoting securities for trading are authorised by the Public Offering Act to collect listing fees from the issuing corporation, as well as trading fees from the parties to any transaction. Appeal of a stock exchange resolution rejecting, suspending, or cancelling a listing of securities on the ground of violation of regulations may be made, within 15 days of issue, to the Ordinary Appellate Courts of the pertinent jurisdiction.

Securities Markets

Trading in securities listed on a stock exchange is conducted through a securities market (*mercado de valores*) affiliated with a stock exchange.

As with the stock exchanges, the securities markets must obtain authorisation to act as such from the Executive Branch through the National Securities Commission, notwithstanding any other requirement set forth by other national or provincial bodies. Securities markets must be organised as corporations. Securities markets may allow trading only of those securities the listing of which has been authorised by the stock exchange to which they belong and those transactions ordered by a court. Securities markets are authorised by the Public Offering Act to collect the trading fees payable by the parties to a transaction.

The internal rules of each stock exchange for its affiliated securities market establish conditions for listing securities, admitting brokers, conducting trades, and controlling the truthfulness of any information required to be reported in connection therewith.

Securities markets are in charge of keeping a registry of stockbrokers and controlling stockbrokers' activities, books, and records. No natural or legal persons may trade on a securities market, use the designation stockbroker, or carry out stockbroker activities unless they are registered with the relevant securities market. Securities markets must report to the National Securities Commission any information concerning new stockbrokers entered in their registry, any cancellation of such registrations, and any changes in connection therewith. Any violation of the Public Offering Act and its regulations by a stockbroker is subject to the disciplinary powers of the securities markets.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. As of 30 October 2009, there were six stock exchanges in Argentina, with affiliated securities markets authorised to quote securities, ie, Buenos Aires, Rosario, Córdoba, Santa Fe, Mendoza, and La Rioja. La Rioja Stock Exchange has the authorisation, but it is not operating.

Buenos Aires Stock Exchange. The Buenos Aires Stock Exchange (*Bolsa de Comercio de Buenos Aires*) is the oldest and largest Argentine stock exchange, having been founded in 1854. Approximately 90 per cent of all the securities in Argentina are traded on the Buenos Aires Stock Exchange. As of 31 December 2008, there were approximately 95 companies trading equity on the Buenos Aires Stock Exchange, five of which are foreign companies (ie, Telefónica, SA; Banco Santander Central Hispano, SA; Repsol, SA; Tenaris SA; and Petrobras (Petroleo Brasileiro SA)).

The Buenos Aires Stock Exchange operates through various mechanisms, these being floor trading *(en el piso)* and the Integrated Computer-Assisted Trading System *(Sistema Integrado de Negociación Asistida por Computador,* SINAC*)* which, when coinciding in trading time, form what is known as the 'concurrent method', and the continuous trading session.

The securities admitted for trading on the Buenos Aires Stock Exchange are corporate stocks, bonds, convertible bonds, small business bonds, trust certificates, Argentine Depositary Shares (*Certificados de Depósito Argentino*, CEDEARs), government bonds, and investment funds. The trades conducted on the Buenos Aires Stock Exchange may be divided into cash and forward transactions. Forward transactions include forward, repos, carryovers, options, securities loans, futures, and short sales. At present, cash trades are settled in 72 hours. Trades may be executed to be settled in pesos, dollars, or transfer dollars between accounts located abroad.

Buenos Aires Securities Market. There are six securities market authorised by the National Securities Commission to participate in the Argentine market for securities. The Buenos Aires Securities Market (*Mercado de Valores de Buenos Aires SA*, Merval) is the largest and most important.

The Buenos Aires Securities Market regulates, coordinates, and implements stock exchange trading, types of securities and trading mechanisms, and terms and conditions of payment. It also has implemented a stock-watch facility to monitor all transactions in real time.

Transborder Electronic Trading Systems. The *Caja de Valores* is a private corporation owned by the national stock exchanges and securities markets. Its principal shareholders are the Buenos Aires Stock Exchange and the Buenos Aires Securities Market.

Caja de Valores acts as depository/custodian of government and corporate securities under Act Number 20,643 and its regulatory decrees and as registrar and transfer agent for corporations and governmental entities.

Caja de Valores has entered into agreements with international clearing and settlement organisations such as Clearstream (formerly CEDEL), Euroclear Operations Centre, and the Depositary Trust Company (DTC) to act in transborder transactions in securities. *Caja de Valores* also has executed an agreement with the *Sociedad Compensadora y Liquidadora de Valores*, *SA*, of Spain, mainly as a result of the trading of Spanish company securities on the Argentine stock exchanges and securities markets.

Off-Market Transactions. Securities also may be traded in Argentina through over-the-counter market brokers who must be linked to an electronic reporting system. The activities of such brokers are controlled and regulated by *Mercado Abierto Electrónico* SA.

The *Mercado Abierto Electrónico* is an electronic exchange where both government securities and corporate bonds are traded through cash and forward contracts. Securities to be traded must be registered with the pertinent supervising authorities and may be traded on the *Mercado Abierto Electrónico*, on other exchanges, or concurrently. The types of securities traded on the *Mercado Abierto Electrónico* are government securities, corporate bonds, treasury bonds, Treasury bills, and provincial bonds. Due to an agreement with the Buenos Aires Stock Exchange, corporate shares are not traded on the *Mercado Abierto Electrónico*. *Mercado Abierto Electrónico* members include national banks, provincial banks, municipal banks, private national banks, foreign banks, cooperative banks, financial institutions, foreign exchange entities, and brokers/dealers.

Securities

National Treatment and Reciprocity. Argentine law accords reciprocal treatment to foreigners who invest capital promoting, supplementing, or developing economic activity in Argentina.[14] 'Economic activity' includes all industrial, mining, agricultural, commercial, financial, and other activities related to the productions or trade of goods and services.

Act Number 21,382 considers 'foreign investors' to be any person, either an individual or a legal entity, domiciled outside Argentina who owns a foreign capital investment, any foreign capital domestic company with investments in other domestic companies, and Argentine individuals or legal entities domiciled outside Argentina. A 'foreign capital domestic company' is any company domiciled in Argentina in which individuals or companies domiciled abroad own, directly or indirectly, more than 49 per cent of the capital stock or control a number of shares whose voting rights are sufficient to prevail at shareholders' meetings.

Emergency and Exchange Regulations Reform Law Number 25,561 of 6 January 2002 and Executive Order Number 214/02 terminated the Convertibility Regime established in 1991 by which the value of the Argentine peso was pegged to the United States dollar. An exchange control regime has been introduced.

14 Act Number 21,382, as amended by Executive Order Number 1853/93.

Currently, a single, free currency exchange market is in force. However, the Central Bank of Argentina may intervene in the market by selling and buying United States dollars to influence the currency price. Additionally, there are limits on purchasing United States dollars per individual or corporation per month.

Transfers of United States dollars abroad are restricted by Executive Order Number 1570/2001, as amended, allowing only such transfers expressly included in its exceptions and by certain limitations imposed by the Central Bank of the Republic of Argentina on the purchase of foreign currency.

For purposes of avoiding the influence of volatile capital in the market, and to create the necessary instruments to follow and control the remittance of funds in and out of Argentina, on 10 June 2005, the Executive Branch issued Executive Order Number 616/2005, imposing certain limitations on the repatriation of funds transferred into Argentina for investment purposes as from such date. Limitations imposed by Executive Order 616/2005 are basically the following:

- Non-residents cannot repatriate their funds before 365 days counted as from their transfer into Argentina; and
- On entry of funds into Argentina, non-residents must deposit with a local financial entity an amount in United States dollars equal to 30 per cent of the funds that have been remitted into Argentina.[15]

Securities Requirements. Formal requisites on securities vary, depending on the type of securities. Shares may be represented by certificates or be registered in accounts kept by either the issuer, the *Caja de Valores* (the Securities Depositary and Clearance Agent), or a commercial or investment bank. Most issuers tend to use book-entry securities.

As regards securities certificates issued in a physical form, the Buenos Aires Stock Exchange requires that issuers meet strict security standards concerning paper quality, printing process, and controls over preparation for certificates by the printing company. Ultraviolet ink and magnetic recognition bands or other similarly effective safeguards are required.

Prior to printing, a model of the certificate and a description of the proposed security procedures should be submitted to the Buenos Aires Stock Exchange. Printing of certificates with facsimile signatures requires approval by the National Securities Commission. If the company chooses to issue book-entry securities through a computer-based registration system, the requirements provided in the Rules should be complied with, except where maintenance of the register is assigned under a contract to the *Caja de Valores*.

The Buenos Aires Stock Exchange requires issuers to provide a detailed description of the system they intend to use for book-entry registration of shares. Such system should afford reasonably safe conditions for certification, exercise, and transfer of rights on the shares.

15 This mandatory deposit may neither accrue interest nor be used as guarantee or collateral of credit transactions of any kind. Such deposit should be made for one year. After such one-year term, it can be either repatriated or exchanged for local currency. Certain exceptions to this regime have been gradually introduced.

Section 4 of Executive Order Number 677/01 requires that, notwithstanding special provisions applicable to each security or those established in the issuance documents, the following legal system be applied to registered or book-entry recorded securities:

- The creation, issuance, or transmission of interests, liens, provisional remedies, or any other assessment on the rights granted by the security must be filed in special registries kept by the issuer or, on behalf of the issuer, by an authorised securities depository or commercial or investment banks, or appointed registration agents, and must have legal effects enforceable to third parties as from the date of said registration;
- The authorised entity keeping book-entry registry of the securities must give the holder a certificate of the account opening and of any movement therein. Holders must have the right to have been delivered, at any time, a certificate of the account balance, at their own expense. Certificates must specify the date, time, type, number, and issuer of the securities, and any other information that may identify the issue; the holder's complete identification, interests, and provisional remedies levied on the securities; and evidence of the issue of the account balance certificates and type, specifying the date of issuance and their maturity dates;
- The issuance of an account balance certificate for the purposes of transferring securities or creating interests on them will cause the account to be blocked for 10 days;
- The issuance of account balance certificates for attending shareholders' meetings or exercising voting rights will cause the account to be blocked until the day immediately following the one when the corresponding meeting was held. If the shareholders' meeting is adjourned or is held on a different date or time, new certificates must be issued in the name of the same persons who have been authorised by the issuance of the original certificates; and
- Account balance certificates may be issued to authorise the holder to file legal claims or file arbitration proceedings, as the case may be, including summary proceedings if applicable, to submit credit verification applications, or to participate in universal actions, for which purpose the certificate will be considered as conclusive evidence, without further authentication or requirement. Its issuance will cause the respective account to be blocked, except for recording acts of disposition by the holder, for 30 days, unless the holder returns the certificate or receives within the term an order to extend the time during which the account should be frozen, issued by a judge or arbitration court. Certificates must indicate such circumstances.

A third party purchasing book-entry registered or recorded securities for a valuable consideration from a person that, pursuant to the corresponding registry, is legally capable of transferring them will not be subject to repossession unless such person, when purchasing the securities, has acted in bad faith or fraudulently.

Global certificates representing securities may be issued in favour of the persons having a stake in them. The account blocking will only affect those securities mentioned in the certificate. Certificates must be issued by the domestic or foreign entity in charge of the administration of the collective deposit system where the global certificates are registered. When the entities in charge of administering the collective deposit system participate in

global certificates registered in collective deposit systems administered by another entity, the former can directly issue certificates. In the case of global debt certificates, the trustee, if any, must obtain the authorisation mentioned above by proving the respective appointment.

Corporate Governance. The Commercial Companies Act provides for the basis of corporate governance of all legal commercial entities. The National Securities Commission Rules supplement the regulations for public companies. A legal entity making a public offering of its securities must have an administrative body (board of directors), a supervisory body (statutory auditors or supervisory council), and an audit committee (*Comité de Auditoría*).[16] In addition, the issuer is required to retain external independent auditors for preparing and filing required periodic documentation.

The National Securities Commission has approved the 'Suggested Ethic Code for Corporate Governance and Good Practices'. The purpose of the Code is to assure that issuers incorporate certain principles to their day-to-day operations, such as full disclosure, transparency, efficiency, protection of investors, and equal treatment among investors. The Code is mandatory and issuers must include in their financial statement an explanation of the reasons why they have decided not to adopt a code for corporate governance and good practices if the board of directors takes such decision.

Shareholders' Meeting. An ordinary shareholders' meeting must be held annually to approve the financial statements (which should, in turn, be filed with the National Securities Commission and the stock exchange where the securities of the company are traded), appoint directors and consider their performance and fees, and authorise a capital increase. An extraordinary shareholders' meeting can be held at any time, provided that prior publications and notices are rewarded in accordance with the applicable regulations.

The holding of the ordinary annual shareholders' meeting at the first summons requires the presence of shareholders representing the majority of the voting shares of the company. At the second summons, the shareholders' meeting must be considered held when the requisite number of shares is present. Resolutions in both cases are to be taken by the absolute majority of votes present, except when the by-laws require a greater number.

Pursuant to Executive Order Number 677/01, shareholders representing at least two per cent of the corporate capital may deliver comments or proposals related to the company's business corresponding to the fiscal year up to five days before the date established for the ordinary meeting. The board of directors must inform the shareholders that such comments or proposals are at the main office or that they may be consulted through electronic means.

To those matters that the ordinary shareholders' meetings of public companies must decide, Executive Order Number 677/01 added the following:

- The disposition or encumbrance of all or a substantial part of the corporate assets of the company when not carried out in the ordinary course of the company's business; and

16 Executive Order Number 677/01.

- The execution of management agreements or any other agreement in which the goods or services received by the company are totally or partially paid with a percentage of the company's income, results, or profits if the amount is substantial, taking into account the business and the shareholders' equity.

In principle, an extraordinary shareholders' meeting at the first summons requires the presence of shareholders representing at least 60 per cent of the shares with the right to vote, if the articles do not require a higher quorum. At the second summons, the attendance of shareholders representing 30 per cent of the voting shares is required, unless the by-laws provide for a higher or lower quorum. Resolutions in both cases are to be taken by the majority of votes present at the meeting, except when the by-laws require a greater number.

In the event of dealing with conversions into another legal entity, premature winding up of the company, transfer of the company's domicile abroad, fundamental change of the purpose, and the total or partial reimbursement of capital, both in the first and in the second summons, the resolutions are to be taken by vote of the majority of voting shares of the company, without applying the plurality of votes. This stipulation is to be applied to decide on mergers or splits, except with respect to the company being taken over which is governed by stipulations on the increase of capital.

Board of Directors. Directors of an Argentine corporation are appointed by the shareholders at the incorporation process and, subsequently, by ordinary shareholders' meetings. Public companies must have at least three directors. Alternate directors may be appointed in accordance with the company's by-laws. Alternate directors replace principal directors in case of vacancy.

The term for directorships must be provided for in the company by-laws. The term cannot exceed three years, but directors may serve subsequent terms. If nothing is provided for in the by-laws, the Commercial Companies Act considers that the maximum term has been chosen. Except otherwise provided by the company's by-laws, a board of directors must meet at least once every three months, and a majority of its members must be present to form a quorum.

The directors and the president of a corporation may be foreigners; however, a majority of the members of the board of directors must be resident in Argentina. All directors have a right to compensation pursuant to the Commercial Companies Act. Compensation may be set in the by-laws of the company or by the shareholders at a shareholders' meetings and cannot exceed 25 per cent of the profits of the corporation, or five per cent if no dividends have been declared. All directors of a corporation are subject to a standard duty of loyalty and diligence. Non-compliance results in an unlimited joint and several liability for damages arising therefrom. Directors of a corporation have a duty to:

- Disclose any conflict of interest to the board of directors and statutory auditors;
- Abstain from voting in any deliberation related to such conflict; and
- Refrain from competing with the company.

Directors are jointly and severally liable for the negligent performance of their duties, or for violations of the law or of the by-laws or regulations of the company. Directors who file

written objections promptly and give notice to the statutory auditors before the proceedings are initiated against acts of the board of directors are exempt from any consequences arising therefrom.

Directors may be exonerated from liability with respect to the company by a subsequent approval of the shareholders' meeting, provided that they have not violated the law or the by-laws, and shareholders representing five per cent or more of the company's capital do not object to such exoneration.

Statutory Auditors. The shareholders' meeting must appoint statutory auditors in odd numbers (a minimum of three) to act as the internal controlling body of the company (*comisión fiscalizadora*). Statutory auditors must be attorneys or public accountants, or civil organisations thereof, and live in Argentina. Directors, managers, or employees of the company or a subsidiary or the company's controlling company cannot be appointed as statutory auditors.

Statutory auditors are jointly and severally liable for non-complying with their duties and obligations, as provided for in the by-laws and by law. In addition, statutory auditors are jointly and severally liable for directors' violations of the law or the by-laws or regulations of the company when the damage caused would not otherwise have occurred.

Audit Committee. Executive Order Number 677/01 creates a new body for public companies, the audit committee (*Comité de Auditoría*). Those companies making a public offering of their shares must establish an audit committee formed by three or more members of the board of directors, the majority of whom must be independent pursuant to the criteria established by the National Securities Commission. The audit committee must submit an annual plan for the fiscal year to the board of directors and the supervisory council.

Registration of Public Offering. Under an agreement between the National Securities Commission and the Buenos Aires Stock Exchange, effective 10 July 1992, applications for registration with the National Securities Commission also must be filed with the Buenos Aires Stock Exchange. The Buenos Aires Stock Exchange must submit its preliminary opinion as to whether the issuer complies with the requirements established in the Public Offering Act within 20 business days. The 20-day term is interrupted should the Buenos Aires Stock Exchange require additional information to the issuer. The Buenos Aires Stock Exchange submits its findings and a preliminary opinion to the National Securities Commission for a final decision once the Buenos Aires Stock Exchange has completed all necessary investigations and reviews.

Thereafter, the National Securities Commission has 10 business days for analysing the issuer's request. If the National Securities Commission does not require additional information or no observations are made on the issue's petition, the issuer is deemed to be registered to make a public offering of its securities. Companies intending to make a public offering are required to submit an application signed by the chairman of the board of directors to the National Securities Commission. In addition, the following documentation must be filed:

- Name of the issuer, main business, registered office, administrative headquarters, telephone and telefax number, and e-mail address;

- Particulars regarding incorporation, registration, and amendments to the by-laws;
- Number of shareholders and names and addresses of shareholders owning more than five per cent of the corporate capital stock;
- Composition of the capital stock (classes and number of shares and a description of their different rights, if any);
- Statement of irrevocable capital contributions, with a detailed list of contributors, relationship with the company, kind of contributions made, capitalisation conditions, and date of approval by the company;
- Description of the issuer, closing date of the fiscal year, a description of the economic group to which it belongs, if any, affiliates, controlling and controlled companies, and stock exchanges on which the company must list its securities;
- Financial statements for the three most-recent fiscal years;[17] and
- Information as to any material events influencing the development of the company or likely to have an effect on its economic or financial performance and condition, other than those disclosed in the financial statements.

The application also must include:

- A copy of the special shareholders' resolution to apply for registration of the company with the National Securities Commission;
- A copy of the by-laws and a statement of amendments thereto, if any, pending approval;
- An independent public accountant's report, evidencing that the corporation is an ongoing concern and that it has an administrative structure capable of meeting the requirements established for companies going public;
- A listing of the members of the board of directors and statutory auditors (regular and alternate) and top managers, stating in detail their personal and special domiciles and positions held in other companies or entities;
- A prospectus complying with the requirements of chapter VIII of the National Securities Commission Rules; and
- Any other information or documents required under stock exchange rules and regulations.

Section 36 of Executive Order Number 677/01 prohibits taking part in a public offering without authorisation. All individuals or corporations taking part in a public offering of securities, forward contracts, futures, and options without the authorisation of the National Securities Commission or in violation of Executive Order Number 677/01 and the Public Offering Act will be subject to the penalties established in section 10 of the Public Offering Act, as amended by Executive Order Number 677/01.

Foreign Companies. The National Securities Commission General Rule (chapter VII1a) provides that companies incorporated in foreign countries may offer shares to the public

17 If the latest financial statement is older than five months as of the application date, special financial statements as of a date not later than three months prior to the application date must be submitted.

in Argentina under the same conditions and requirements as those applicable to Argentine issuers. The issuers must establish a permanent representation and a domicile in Argentina and file data with the Public Registry of Commerce, complying with requirements of section 118 of the Commercial Companies Act. They must specify whether they make public offerings of securities in foreign countries and, if so, detail all initial and ongoing disclosure requirements to which they are subject.

The National Securities Commission Special Rule (chapter VII1 b) allows the National Securities Commission to establish less extensive requirements for companies authorised to make public offerings of shares in countries with which cooperation agreements have been executed or where, failing such agreement, the National Securities Commission deems that existing regulations provide reasonable protection for domestic investors and ensure an adequate disclosure system.

Argentine Depositary Receipts Issuance Programmes. Argentine Depositary Receipts Programmes (CEDEARs) are the second mechanism provided for in the Argentine securities market regulations allowing foreign investors to access the Argentine market. The National Securities Commission Rules (chapter VII3) provide for the authorisation of CEDEARs. CEDEARs represent deposited securities of foreign companies not authorised to make public offering of them within the territory of Argentina. Underlying securities must be listed within a Mercosur market or other foreign markets whose regulatory authorities have executed an agreement with the National Securities Commission.

CEDEARs may be issued by the *Caja de Valores*, commercial or investment banks, and finance companies authorised by the Central Bank. CEDEAR issuers must meet an A $30 million minimum capital requirement. Authorised depositaries may be:

- The CEDEAR issuer;
- The *Caja de Valores*;
- The central depositary in the country of issue of the securities represented by CEDEARs; or
- A custodian bank in the country of issuance of the underlying securities with an A $200 million minimum shareholders' equity.

International clearing houses, such as Clearstream or DTC, also may act as depositaries. A depositary may not acquire ownership or use of the underlying securities represented by CEDEARs, which are held under a regular deposit agreement. The depositary may not be changed unless a majority of CEDEAR owners so decides. Neither an advanced nor a general consent to change the depositary may be admitted.

CEDEAR issuers must maintain an amount equivalent to the underlying securities. On a case-by-case provisional basis, the National Securities Commission may authorise issuance of CEDEARs without underlying securities, in so far as prior guarantee is furnished. CEDEARs are freely exchangeable, at the owner's request, for the underlying securities at any time and/or at the programme's expiration. CEDEARs must be cancelled and destroyed against delivery of underlying securities. As of 30 October 2009, there were 22 authorised CEDEARs trading on the Buenos Aires Stock Exchange.

Prospectus Requirements. Chapter VIII of the National Securities Commission Rules establishes rules that issuers must follow in preparing and filing prospectuses, depending on the characteristics of the proceedings being followed with the National Securities Commission. Foreign issuers also must include additional information already filed with foreign markets authorities.

The National Securities Commission Rules state that a prospectus constitutes the basic document of the offer and, therefore, it must be an easy-reading document which may allow unsophisticated investors to understand its terms and conditions. The prospectus must be signed by persons capable of binding the issuer.

Executive Order Number 677/01 establishes that issuers of securities, jointly with members of the board, statutory auditors as to matters for which they are competent, the offeror of securities as regards information related to them, and persons signing the prospectus for the issue of securities will be liable for all information included in the prospectus registered with the National Securities Commission. The intermediary entities and agents in the market taking part as arrangers or underwriters of a public offering for the sale or purchase of securities must review the information contained in the offering prospectus. Experts or third parties giving an opinion on certain sections of the prospectus, as attorneys or public accountants, will be liable only for the information on which they have given an opinion.

While the issuance of securities is being analysed by the National Securities Commission for approval, the issuer may distribute a preliminary prospectus. The issuer must complete any modification to the filed prospectus required by the National Securities Commission within 10 business days following notification. The prospectus must contain:

- Information on the directors, managers, legal and financial counsel, and statutory auditors;
- Statistical data (number of securities to be offered, price or method to determine it, amount expected to be received, percentage that the new issuance must represent in the capital stock, and ratio price/book value of the securities);
- The programme for the offer (period of the offer and the right of the offeror to extend or to reduce the period, underwriters, places where the purchase or subscription forms must be received, deadline and way to pay-in the securities by the acceptant of the offer and to deliver the securities by the offeror, including proceedings to exercise pre-emptive rights, if any, and date and means of publication of the outcome of the offer);
- Issuer financial information (consolidated financial data; for the last three fiscal years, or as from the incorporation of the issuer, whichever occurs first; ratios and principal ratios for the last three fiscal years, or as from the incorporation of the issuer, whichever occurs first, describing liquidity, creditworthiness, locked-up capital, and profitability; and capitalisation and incurred indebtedness, purposes of the offer and uses of the amounts to be raised, and risk factors);
- Information on the issuer (history and development of the issuer, structure and organisation of the issuer's business group, corporate information, operating and financial review and prospects, operating results, liquidity and capital resources, research, trade mark and licence development, and business trends);

- Information as to directors, senior management, and employees (director and senior management compensation, shareholding and stock option plans, statutory auditors and special committees, number of employees of the last three fiscal years, significant change in number, and agreements granting participation in the capital stock);
- Information as to major shareholders and related-party transactions (list of shareholders owning at least five per cent of every class of shares with voting rights of the capital stock, or less if so required by the foreign law should the issuer be a foreign company, and information as to any significant change in the capital stock and related-party transactions for the last three fiscal years);
- Financial information; and
- Offer and listing information (listing details, describing the class of securities being offered, par value, rights thereon, restrictions on free conveyance of title to securities and credit rating, distribution plan, markets where the securities will be offered, difference in the price of offered securities and prices paid by directors and senior managers in the last five years, and costs and expenses incurred by the issuer in the offer).

Periodic Disclosure

Official Trade

Chapter XXI, section 22, of the National Securities Commission's Rules establishes obligations for stock exchanges and securities markets where securities are traded regarding information to be made available to investors.

Stock exchanges and securities markets must adopt measures to secure free access to information, accuracy, and diffusion, without prejudice to the powers of the National Securities Commission. They must publish on a daily basis the details of all the transactions carried out, specifying their nature, price, and the hour, minute, and second of completion.

Foreign Issuers with Primary Admission

According to Chapter VII of the National Securities Commission Rules, foreign corporations must comply with the disclosure and reporting requirements applicable to domestic issuers whose shares are listed on the special section. The National Securities Commission may authorise the applicant to make only the required ongoing disclosure under the counterpart authority in the issuer's home country, but the issuers and persons falling within the scope of the applicable stipulation must comply with chapter XXI, 'Transparency in the Public Offering', of the National Securities Commission Rules. Historically, the National Securities Commission has authorised applicants to disclose only the financial data required in the foreign issuer's country, provided that such data is consistent with the Argentine GAAP.

Foreign corporations must report their share market prices and trading volume in foreign markets on a daily basis to the Argentine stock exchanges from which they have requested authorisation to trade their securities. The National Securities Commission may change the reporting frequency based on the mode of operation of the foreign market places where such securities are traded.

Issuers of Registered Securities

In General

Under the National Securities Commission Rules and the Buenos Aires Stock Exchange regulations, listed companies must file their financial statements within 70 calendar days after the end of their fiscal years or after the term of two days following the board of directors' approval, whichever occurs first, and no later than 10 days prior to the date on which the general shareholders' meeting is to be held to consider them. Additionally, the companies must submit the following information:

- Board of directors' report to shareholders;
- Balance sheet;
- Statement of income;
- Statement of cash flow;
- Consolidated financial statements;
- Management discussion and analysis of financial position, containing a summary of financial information;
- Report of the statutory auditors on the company's financial conditions and results of operations, board report, and financial statements;
- Auditors' report; and
- Minutes of the board of directors' meeting where the above documentation was considered and approved.

In addition, the Buenos Aires Stock Exchange requires that, within 48 hours after the board of directors' meeting that approved the above documentation, the company submit it for shareholder approval in a letter, stating the results for the period/year, amount of unappropriated earnings, stock and cash dividends as proposed at the board of directors' meeting, and capitalisation of adjustments and surplus.

Foreign investors may file the information stated above translated into English and with figures stated in United States dollars. Those companies whose shares are traded on foreign markets must file with the National Securities Commission all the information required by their foreign markets.

Within 42 calendar days after the end of each quarter during the year or within two days after the board of directors' approval, whichever occurs first, the company must submit to shareholders the same financial information as that specified for the fiscal year, excepting the board of directors' report. Members of corporate bodies, principal and alternate, must submit to the National Securities Commission:

- Within 10 business days after taking office, an affidavit detailing the shares and other publicly traded securities issued by the company directly or indirectly held or managed by them;
- Prior to 1 March of each year, another affidavit updating that indicated above; and

- On a monthly basis, on the fifteenth day of each month, an affidavit in respect of changes in the holding or management of securities, if such charges have occurred.[18]

Individuals or legal entities controlling or belonging to the group controlling the company must submit an affidavit within five business days after execution of any transaction entailing the acquisition of five per cent of the voting rights on any issuer's capital stock.

The directors of a registered and listed company, or its statutory auditors, must report to the National Securities Commission any material favourably or adversely potentially affecting the company's operation or trading of its securities on the market. The information must be forwarded immediately after occurrence of the event or after the above officials have become apprised thereof, if such event is the result of third-party action, and it must be published in the *Buenos Aires Stock Exchange* daily bulletin.

Executive Order Number 677/01 requires any person entering into any shareholder agreement or any other agreement that restricts the free transfer of shares of any issuer, the voting rights, or the corporate governance or that grants preferred rights to disclose such agreement to the National Securities Commission and exchanges where the issuer's securities are traded.

Argentine Depositary Receipts Disclosure Requirements

For sponsored CEDEARs, issuers of the underlying securities must provide financial statements consistent with effective regulations in Argentina. Information must be submitted and published in Spanish. Information on issuers also must be published.

Information on non-sponsored CEDEAR issuers must, within 10 days, submit any information that issuers of the underlying securities have disclosed or submitted to their regulatory authority. They also must submit any relevant information within 24 hours after receipt or disclosure thereof, as well as accounting information within 10 days. Furthermore, CEDEAR issuers must comply with chapter XXI of the National Securities Commission Rules.

CEDEAR issuers also must provide annual and quarterly financial statements and disclose any material change in their own fee schedule or that of the depositary. CEDEAR issuers must report quarterly on the number of outstanding depositary receipts as of the first day of the financial year, exchanged certificates, newly issued certificates within a CEDEAR programme, and outstanding certificates at quarter-end, as well as the amount of securities represented by CEDEARs within each programme.

Proxy Disclosure

Executive Order Number 677/01 introduces new proxy disclosure rules. The rules will not be operative until the National Securities Commission issues the required regulation.

18 This requirement also is applicable to persons no longer in office, for a period of six months after the date on which they ceased to hold office.

Shareholders intending to publicly request the granting of proxies in their favour must do so according to the rules to be established by the National Securities Commission for that purpose. Such shareholders must hold a minimum of two per cent of the capital stock represented by voting shares and a shareholder seniority of at least one year. The representation must be irrevocable and for a specific meeting.

The shareholders will be liable for the information included in the proxy form registered with the National Securities Commission. In addition, the proxy solicitors must be responsible for distributed information. The information must allow shareholders to make a decision with full knowledge on the issue subject to solicitation. Solicitors will be subject to the penalties established in the Public Offering Act, as amended by Executive Order Number 677/01.

Corporate governance regulations are fully addressed in the Commercial Companies Act and regulations passed by the Public Registry of Commerce. However, public companies also are governed by the specific provisions of the Public Offering Act.

It is not usual that the National Securities Commission varies the legal general corporate framework governed by the Commercial Companies Act. However, due to the nature and mechanics of public companies, certain differences between both kinds of companies exist.

Participation of foreign shareholders (ie, either individuals or foreign corporate shareholders) in public companies has never been a major issue. However, due to certain changes in corporate governance policies, the Public Registry of Commerce imposed certain requirements that should be complied with by foreign companies in order to participate as foreign corporate shareholders of local corporations.

The National Securities Commission modified the formal requirements applicable to be present and vote at shareholders' meetings of public companies. In that regard, section 25 of chapter II of the Rules has been amended, providing for evidence of the corporate shareholder's incorporation and requesting 'express individualisation of the Registry and its jurisdiction'.

Unfortunately, this definition is not clear and raised the issue of whether or not the registration that the National Securities Commission is requiring is the one required for the foreign corporate shareholder's place of incorporation or the local registration required by the Commercial Companies Act and Public Registry of Commerce. Notwithstanding the above uncertainty, according to current criteria, it is not required for foreign companies to be registered with the Public Registry of Commerce to be a nominal and 'passive' shareholder of a public company.

However, a foreign company will be required to provide evidence of its registration if it wants to attend a shareholders' meeting of the public company (registration in its home country should be, in principle, sufficient). Registration with the Public Registry of Commerce will be required if the foreign company wishes to cast votes in the meeting and its voting contributed to form the shareholders' meeting decision.

Electronic Submission of Information

All entities supervised or monitored by the National Securities Commission, local or foreign, must provide the information expressly required by the National Securities Commission

Rules through the Internet, by using the electronic means provided by the Financing Information Highway (*Autopista de la Información Financiera*, AIF).[19] Information filed with the National Security Commission also must be filed with the Buenos Aires Stock Exchange and the *Mercado Abierto Electrónico SA*.

Trading Rules

Securities Offerings

Offer. The Buenos Aires Stock Exchange regulations provide for certain conditions generally applicable to any securities offering. The purpose of the corporation and its capital stock, financial condition, and operating performance must justify access to the stock market. It must have an administrative organisation capable of meeting the requirements of the listing rules and supplemental regulations.

In addition, companies applying for original listings of shares on the Buenos Aires Stock Exchange must submit the following documents and information with the application:

- Certification of public offering approval by the National Securities Commission, or simultaneous filing of application for such approval;
- Minutes of the special shareholders' meeting, containing the corporate decision to apply for registration and a statement of the reasons for such decision;
- A statement as to whether the company has any mortgaged assets;[20]
- A statement as to whether the corporation holds any concessions from a government, national or provincial;[21]
- A statement as to whether the company pays any royalties, specifying the beneficiaries thereof and the items for which said royalties are payable;
- A statement as to whether the company has any exclusive sales agreements within or outside Argentina, for the whole or part of its production;[22]
- A statement as to whether the company has any agreements in place for assistance or advice of any kind, payable on the basis of production, sales, or profits;[23]
- A sworn statement by the members of the board of directors, statutory auditors, or supervisory committee, and reporting certified public accountant on a Buenos Aires Stock Exchange form, including personal address, special domicile, identification document number, and positions held in other companies;

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19 National Securities Commission Rules, ch XXVI; see http://www.cnv.gov.ar.

20 If so, the issuer must state the book value of the mortgaged assets as per the most recent balance sheet, the original amount of the mortgage, the term of the loan secured thereby, the balance outstanding as of the listing application date, and all such other information as the corporation may deem appropriate to provide.

21 If so, the concession contract should be submitted, as well as a reference to the legal provision governing it.

22 If so, specify the scope of such agreements and identify the counterparties thereto and any direct or indirect relationships with such counterparties.

23 If so, specify the scope of such agreements and identify the counterparties thereto and any direct or indirect relationships with such counterparties.

- A statement as to whether the corporation has any subsidiaries under section 33, subsection 1, of the Commercial Companies Act;[24]
- Facsimiles and numbering of shares and bonds and a schedule showing the number of shares represented by each certificate in accordance with existing regulations;[25]
- Any other documentation required by the National Securities Commission's Rules; and
- Whether the applicant company already lists its shares on other stock exchanges, national or foreign.

The listing application should be signed by the corporation's legal representative on a form supplied by the Buenos Aires Stock Exchange. Applicants are to provide all such clarifications as the Buenos Aires Stock Exchange may require. If the application for listing is approved, the Buenos Aires Stock Exchange will prepare a summary description of the company's background and activities based on the documentation and information provided by it, publish that description and the listing authorisation, and communicate such authorisation to the company.

Listing Sections. The Buenos Aires Stock Exchange has two listing sections for shares of stock:

- The special section for shares of issuers having a capital of over A $60 million, or sales or service revenues in excess of A $100 million, or 1,000 shareholders or 30 per cent of the voting capital stock (1,200 shareholders and 40 per cent of the capital stock if the shares are non-voting stock) not related as among themselves by agreements concerning the governance or management of the company, or listed securities for a par value higher than A $60 million; and
- The general section for companies which have 150 shareholders or 20 per cent of the voting capital stock (200 shareholders or 30 per cent of the capital stock if the shares are non-voting stock) not related among themselves by agreements concerning governance and management of the corporation or not complying with the requirements provided in the special section.

Without prejudice to the ownership distribution criteria established by the National Securities Commission, companies not meeting the required minimum number of shareholders will have the following options:

- Submit a commitment signed by the shareholders to offer to the public trading market any amount of the capital stock, in one or more offerings within the six months after listing until reaching the capital requirements;

24 If so, the corporation must furnish the following data: (a) two copies of the financial statements for the last three fiscal years, (b) a list of directors, statutory auditors, or supervisory committee members and partners if such subsidiaries are business organisations other than corporations, (c) a detailed description of the business, and (d) a breakdown of receivables from and payables to such subsidiaries if such receivables or payables are subject to fair market value terms, and the reasons for such a treatment.

25 If applicable, a description of the system used for book-entry shares, with certification of approval by the National Securities Commission or relevant provincial agency, except for Mendoza, if a computerised record is kept.

- Resolve to issue shares for subscription, for a par value;[26] or
- Place the shares through the underwriters within six months as from the listing authorisation.

Once the Buenos Aires Stock Exchange's minimum ownership distribution requirement (5 per cent) has been met, the company should demonstrate compliance with the higher percentages required by the National Securities Commission within one year after listing. Companies already admitted to trading seeking to list subsequent issues of shares must provide the Buenos Aires Stock Exchange with a copy of the company's decision within the following 10 days and with the following information:

- Characteristics of the securities;
- Pre-emptive rights;
- Placement method, date and form of payment, and date as from which the shares are entitled to dividends;
- Once the issuance has been completed, a reporting on the results thereof; and
- Prospectus for the public offer.

Indices. The Board of Directors of the Buenos Aires Securities Market (Merval) has approved the creation of the 'MERVAL 25', a new stock-exchange index including a fixed number of companies, designed to reflect the performance of the 25 most-important shares measuring their liquidity, conserving the basic structure of the traditional Merval Index. The MERVAL 25 index measures the 25 stocks traded in the Buenos Aires Stock Exchange with the largest negotiated volume and number of transactions, excluding those stocks that have not been traded for a determined number of days.

The MERVAL ARGENTINA Index is based on the trades made on the six-month period previous to each updating. Trades of foreign companies and CEDEARs are excluded. The criteria applied for the selection is to decrease the participation in the cash segment of the concurrent market and to exclude all the companies the shares of which have not been traded in a significant number of trading sessions.

By updating the portfolios from that date onwards, in accordance with the new index methodology, the situation may be deemed as a bifurcation of the MERVAL Index, as from 1 March 2000, into two indexes:

- MERVAL, the traditional index, conceived as an indicator of the profitability of stocks traded at the Buenos Aires Stock Exchange; and
- MERVAL ARGENTINA, the new index, reflecting the profitability of an Argentine company's stocks portfolio.[27]

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26 The company should provide to the Buenos Aires Stock Exchange certification of the shareholders' individual waivers of their pre-emptive rights for the amount needed to release the above percentage. The issue should be completed within six months after listing.

27 The portfolio, which limits each company's share to a maximum 20 per cent, acts as an average indicator of their behaviour in the Concurrent Market.

The MERVAL Index is the market value of an equity portfolio, selected according to market share, number of transactions, and quotation price on the Buenos Aires Stock Exchange. The MERVAL Index is reckoned on a continuous basis during any trading day, and it is screened across the Market Data System terminals. Listed corporations and weighted prices are updated quarterly, consistently with market share for the last three months.

The BURCAP Index represents the value of an equity portfolio composed of those securities included in the MERVAL Index. The contribution of each share of stock is in proportion to its market value as of the base date. Every time the MERVAL Index is structured, the same procedure is applicable to the BURCAP Index. Notwithstanding the significance of the MARVAL Index, the VALUE Index appears to be the more complete as long as it represents the evolution of the whole listed common shares. The Index is adjusted in case of the beginning or withdrawal of quotation, equity reduction, or subscription of new shares. In this case, the base value is multiplied for the adjustment factor.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties. Individuals or corporations, directly or through other individuals or corporations, or any group of individuals acting on a concerted basis, by any means and for a specific purpose, who acquire or sell holdings granting five per cent or more of the votes of a trading company must report such transactions to the National Securities Commission.

Individuals or corporations, directly or indirectly owning substantial share-holdings, also must notify the stock exchange and securities market with which such securities are registered.

Company Duties. Pursuant to chapter XXI, section 2, of the Public Offering Act, companies must give notice of the acquisition by third parties of five per cent of the voting shares of stock of the company.

Insider Trading and Fraud

Insider Trading. The National Securities Commission Rules determine which acts are deemed to have been performed against the transparency within the scope of the public offering. Directors, managers, statutory auditors, supervisory council, controlling shareholder, and professional counsels of the issuer; any person having access to the information; rating agency personnel; private entity personnel involved in the public offering, including the *Caja de Valores*; public entity personnel involved in the public offering, including the National Securities Commission; and any persons who accidentally or by their temporary relationship may have access to privileged information for their own benefit or for the benefit of third parties are prohibited from:

- Using the privileged information therein mentioned to obtain any kind of advantages for their own benefit or for third-party benefit, whether resulting from the purchase or sale of marketable securities futures, options, or any other kind of transaction related to the public offering regime; and

- On their own account or on behalf of third parties, directly or indirectly, preparing, facilitating, participating in, or performing any kind of transaction on the market, regarding the marketable securities, futures, or options referred to in the information, communicating such information to third parties, unless in the ordinary course of its employment, profession, office, or craft, and advising a third party to acquire, or assign marketable securities, futures, or options or causing third parties to purchase or assign them, based on such information.

Manipulation and Fraud on the Market. Chapter XXI, section 7, of the National Securities Commission Rules provides that issuers, intermediaries, investors, and any other party intervening in the securities, futures, and/or options market must:

- Refrain from performing any act or engaging in conduct seeking or allowing mishandling of prices or volumes of marketable securities, futures, or options traded on such markets; and
- Refrain from performing any other act or conduct capable of defrauding any individual or corporation participating in the above-mentioned markets.

The above-mentioned acts or conduct include, but are not limited to, any act, practice, or course of action intended to artificially affect the formation of prices, liquidity, or the traded volume of one or more than one marketable securities, futures, or options[28] or induce a party to err in intervening in the market. These acts include any misrepresentation made knowing that it was inaccurate or deceitful or which should be reasonably considered as such and any omission of essential information capable of inducing error by those obliged to provide it.

The National Securities Commission may impose on any market participant mentioned above the penalties provided in the Public Offering Act, as amended by Executive Order Number 677/01.

Public Take-Over Bids

In General. The Public Offer Resolution establishes the proceedings, rules, and regulations on public takeover bids, either for cash or through an exchange of shares. It also provides that any person or entity intending to launch a public offer bid or a securities exchange bid must previously obtain government approval. Any public offer bid or shares exchange bid for shares of companies admitted to the public offering regime must be addressed to all registered shareholders, including those whose shares lack voting rights.

28 Such transactions include those not effectively causing the transfer of the marketable securities, futures, or options and those carried out for the purpose of creating the false pretence of the existence of the supply and demand or an active market, even when the marketable securities, futures, or options are effectively transferred.

If it is a mandatory public take-over bid, according to the terms of the Public Offer Resolution, the offer also must be directed to holders of subscription rights or stock options, convertible debt securities, or other similar securities which, directly or indirectly, may grant a right to subscribe for, acquire, or convert them into shares with voting rights.

Procedure. If a public offer bid is launched, either for cash or through a shares exchange, there is a duty for the offeror to file:

- A declaration of the offer, which must include (a) the main conditions, (b) all the minimum and maximum amounts to be acquired, including the procedure for solving the disputes in case of offers below or above the minimum amounts and priorities among the received offers, (c) data relating to the offeror, including information as to the offeror and related parties' participation in the voting capital stock of the target company, and (d) the offeror's board of directors' statement as to the financial solvency to guarantee full payment of the offer;
- A prospectus containing a description of the offer;[29]
- Additional information, including (a) documents evidencing the guarantee required by the National Securities Commission (*Comisión Nacional de Valores*, CNV) regarding the full compliance of the offer, (b) the administrative body's authorisation if it is necessary or legally required, (c) a copy of the minutes of the board of directors' decision to launch the offer, (d) financial statements corresponding to the offeror's last two fiscal years, (e) information on the target company having not yet been disclosed, and (f) an irrevocable purchase commitment, except as to the offered price, which may be increased by not less than 5 per cent; and
- The term of the offer, which may not be less than 20 days nor longer than 30 days, as from the authorisation date.

In all cases, the principle of equal treatment of shareholders must be observed and an additional term of not less than five days and not longer than 10 days as from the general closing date of the term of the offering must be given to those shareholders who had not accepted the offer within the general term.

Types of Offers. The Public Offer Resolution defines the various kinds of public offers created by Executive Order Number 677/01, these being:

- Mandatory public take-over offers;
- Withdrawal from the public offering regime and delisting of securities;
- Simplified mandatory public take-over offers; and
- Competitive bids.

29 The prospectus must contain minimum information requirements set forth in the government's rules and must be filed in a number sufficient to be delivered to the interested shareholders.

Australia

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Australia

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Introduction

Regulatory System

From an Australian perspective, the term 'securities' has a diverse and broad meaning. Within a corporate context, the regulatory system through legislation, regulations and judicial decisions, has sought to define the term 'securities'. This chapter is limited to the definition context of a 'security' in a corporate sense rather than the broader definition of 'securities' under Australian Common Law. Securities regulation in Australia comprises three main areas, namely:

- The law;
- The administration of that law; and
- The resolution of disputes under that law.

The law is mainly found in the Corporations Act 1989 (Cth),[1] the Australian Securities Commission Act 1989, Regulations made under those Acts, and the Corporations Act of each state of Australia, the Australian Capital Territory, and the Northern Territory of Australia. This body of law is colloquially referred to as the 'Corporations Law'. The administration of this federal and state legislation is the responsibility of the Commonwealth Attorney-General and the Australian Securities Commission (soon to be converted into the Australian Corporations and Investment Commission). The resolution of disputes is handled by the Federal Court of Australia (Cth) and the Supreme Courts of each state of Australia, the Australian Capital Territory and the Northern Territory, with other courts having some powers to apply the securities legislation.

In addition, publicly listed companies in Australia must adhere to and comply with the rules and regulations set out in the Listing and Business Rules of the Australian Stock Exchange Limited.

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1 The Corporations Law is in the process of being reformed through the Federal Corporate Law and Economic Reform Program. The reforms are to take effect from 1 July 1998.

Legal Sources

Legislation and Common Law

The substantive law regarding securities in Australia is contained in the Corporations Law. A full understanding of securities law in Australia calls for acquaintance with not only the Corporations Law and judicial decisions interpreting it, but also the general law in Australia governing companies, contracts, trusts, torts and the interpretation of statutes. This chapter will focus on the Corporations Law, with occasional reference to the general law where required.

The Corporations Law came into effect on 1 January 1991, and it is the culmination of eight separately legislated Corporation Acts in force in Australia in the Australian Capital Territory, the Northern Territory, and each of the six states of Australia. The Corporations Law, among other things, deals with the registration of foreign companies, dealings between or by companies, officers of companies, prospectus requirements, raising of capital, and take-overs.

Listing Rules

Certain rules and regulations have been formulated for companies publicly listed on the Australian Stock Exchange Limited. The Listing Rules of Australian Stock Exchange Limited govern:

- Admission of entities to the Official Lists;
- Quotation of securities;
- Suspension of securities from quotation;
- Removal of entities from the Official List;
- Ongoing requirements for listed companies, including disclosure requirements; and
- Dealings by listed companies.

They also govern disclosure and some aspects of the conduct of unlisted entities. Compliance with the Listing Rules is a contractual requirement for admission to the Official List of the Australian Stock Exchange Limited under the contract that an entity enters into with the Australian Stock Exchange Limited on admission.

Enforcement of the Listing Rules of the Australian Stock Exchange Limited is not limited to a contractual context. The Listing Rules are given statutory recognition under the Corporations Law, and they are enforceable against listed entities and their associates. The Corporations Law provides that the Australian Stock Exchange, Australian Securities Commission, or a third party may apply to the court to seek judicial enforcement of the Listing Rules. The Listing Rules create obligations that are additional and complementary to Common Law and statutory obligations.

The articles of association of the Australian Stock Exchange Limited give the Board of the Australian Stock Exchange the power to make Listing Rules. Under the Corporations Law, Listing Rule amendments must be lodged with the Australian Securities Commission and are subject to disallowance by the Minister. The Company's division of

the Australian Stock Exchange Limited makes the day-to-day decisions on the application of the Listing Rules. The principles on which the Listing Rules are based are as follows:

- Minimum standards of quality, size, operations, and disclosure must be satisfied;
- Sufficient investor interest must be demonstrated to warrant an entity's participation in the market by having its securities quoted;
- Securities must be issued in circumstances which are fair to new and existing security holders;
- Securities must have rights and obligations attaching to them that are fair to new and existing security holders;
- Timely disclosure must be made of information which may affect security values or influence investment decisions and information on which security holders, investors and the Australian Stock Exchange Limited have a legitimate interest;
- Information must be produced according to the highest standards and, where appropriate, enable ready comparison with similar information;
- The highest standards of integrity, accountability and responsibility of entities and their officers must be maintained;
- Practices must be adopted and pursued which protect the interests of security holders, including ownership interest and the right to vote;
- Security holders must be consulted on matters of significance; and
- Market transactions must be commercially certain.

Other than these fundamental principles, the Listing Rules also expressly state that an entity must comply with certain general notions of interpretation, such that the Listing Rules must be interpreted:

- In accordance with their spirit, intention, and purpose;
- By looking beyond form to substance; and
- In a way that best promotes the principles on which the Listing Rules are based.

Authorities

Australian Securities Commission

The responsibility for the day-to-day administration of the Corporations Law is vested in the Australian Securities Commission and a number of ancillary bodies. The Australian Securities Commission is a federal government body which administers and ensures compliance with the Corporations Law. The Australian Securities Commission was established by the Australian Securities Commission Act 1989. The Australian Securities Commission is soon to be merged into the Australian Securities and Investment Commission, which will merely extend the Australian Securities Commission's current corporate responsibilities. The Australian Securities and Investment Commission will remain responsible for the administration of the Corporations Law.

The Australian Securities Commission regularly issues practice notes and policy statements which outline the Australian Securities Commission's view on the requirements of certain provisions of the Corporations Law. These act as helpful interpretative documents. The Australian Securities Commission is given a wide range of discretion under the Corporations Law. In an effort to provide guidance to practitioners on how it exercises this discretion, the Commission issues practice notes and policy statements. Those practice notes and policy statements include the policy on both specific discretions and the Australian Securities Commission's approach to its discretions in general.

The Australian Securities Commission is a body corporate with perpetual succession. It must have at least three members who are appointed by the Governor-General of Australia. The fact that the Australian Securities Commission is a body corporate means that the decisions of its members (sometimes referred to as 'Commissioners') when acting as the Commission cannot be made the subject of administrative review under the Administrative Decisions (Judicial Review) Act 1997 (Cth).

The Australian Securities Commission may delegate its powers or functions to other people. Delegates, however, may find their decisions subject to review. The Australian Securities Commission has general powers of investigation. They are listed in the Corporations Law, and they include circumstances where there is reason to suspect:

- Contravention of law;
- Unacceptable circumstances; and
- Contravention of a relevant previous law.

Australian Stock Exchange Limited

The Australian Stock Exchange was incorporated on 1 April 1987, and each of the separate exchanges from each of the states and territories of Australia became subsidiaries or members. Therefore, the Australian Stock Exchange is a national body. On 18 October 1996, the Australian Stock Exchange demutualised and converted into a public company, the Australian Stock Exchange Limited. Plans also are in progress through the Corporations Law (Australian Stock Exchange Demutualisation) Bill 1997 to convert the Australian Stock Exchange Limited from a company limited by guarantee (a 'co-operative' or 'mutual') to a company limited by shares.

The Australian Stock Exchange Limited offers a market for trading in securities which takes place through its member organisations. The constitution of the Australian Stock Exchange Limited and Business Rules govern stockbroker relationships with the Australian Stock Exchange, with each other and with clients. The Australian Stock Exchange Limited supervises the market for securities issued by publicly listed entities. One way it does this is by setting standards for the behaviour of publicly listed entities through its Listing Rules. The objectives of the Australian Stock Exchange Limited include providing:

- A fair and well-informed market for financial securities; and
- An internationally competitive market.

The Australian Stock Exchange's principal activities include providing a trading system, a clearing and settlement system, and regulation of the securities market. The Australian Stock Exchange Limited has an absolute discretion concerning the admission of an entity to the Official List (and its removal) and quotation of its securities (and their suspension). It also has discretion whether to require compliance with the Listing Rules in a particular case, and it may take into account the principles on which the Listing Rules are based when making a decision. It also may waive compliance with a Listing Rule unless the Listing Rule expressly prohibits such a waiver. If it grants a waiver it may do so on conditions.

Sydney Futures Exchange

The Sydney Futures Exchange is the only exchange in Australia on which futures contracts are actively traded. The other futures exchange is the Australian Financial Futures Market, a subsidiary of the Australian Stock Exchange, but trading on this is currently inactive. Chapter 8 of the Corporations Law provides, among other things, that approval is required to operate a futures exchange and clearing house and sets out provisions for the licensing and conduct of brokers and other participants in the futures industry and the conduct of futures business.

It is possible that a declaration be obtained under section 1127 of the Corporations Law that the futures market is an 'exempt futures market'. Generally, applicants for section 1127 declarations are persons who deal in futures contracts in such a way that their activities constitute the conduct of a futures market. An exempt futures market declaration results in the futures market being exempt from various regulations applying to ordinary futures exchanges. The circumstances surrounding each facility provider's business will decide if it is necessary to obtain a futures adviser's licence.

The Corporations Law requires that futures exchanges incorporate certain regulations into their Business Rules. These include rules relating to the admission of members and their training and conduct and accounting practices. Exchanges are required to liaise with the Australian Securities Commission on changes to these rules. The Corporations Law also provides for the protection of clients of futures brokers by a variety of means. These include segregation of clients and broker funds, the provision of information to clients, rules about the conduct of trading, and requiring exchanges to establish a fidelity fund to protect clients against fraud by a futures broker.

The Australian Securities Commission has responsibility for ensuring that all persons licensed as futures brokers or futures advisers and all holders of proper authorities comply with the Corporations Law and licence conditions. These regulations have been set down with a view to ensuring that futures markets in Australia are efficient and well informed and serviced by honest and competent brokers and brokers that are financially sound. As an approved futures exchange pursuant to section 1126 of the Corporations Law, the Sydney Futures Exchange is responsible for ensuring that its members are of good character and high business integrity, conduct their dealings efficiently, honestly and fairly, and ensure that there is an orderly and fair market for dealings in

futures contracts. Similar regulations exist for licensed security dealers, proper authority holders, and investment advisors of ordinary securities.

Procedures

Registration to Carry on Business in Australia

In General. A foreign company may not carry on business in Australia unless it is registered under the Corporations Law or it has applied to be so registered and the application has not been dealt with by the Australian Securities Commission. Even if a foreign company does not wish to carry on business in Australia, it may still need to be registered. If the company wishes to issue, sign, or publish public documents, or issue or sign eligible negotiable instruments within Australia, it will be required to specify its Australian Registered Body Number. This number is only allotted to foreign companies that are registered. Registration is obtained through the Australian Securities Commission. In practice, registering a company in Australia as a foreign company is a four-step process. The steps are:

- Reserving the name;
- Completing relevant application form;
- Assembling company documents; and
- Lodging the form and associated documents, with the prescribed fee.

Reserving Name. Reservation of a distinct company name is achieved through application to the Australian Securities Commission. If it is decided not to reserve a name, the Australian Securities Commission will only register the company if the name specified on the application form is available. The form requires general details about the body corporate to be registered.

Accompanying Documents. Any documentation that is not in English must be accompanied by a certified translation. There are specific requirements relating to the translation of documents. The following documents are required to be lodged with the application for registration:

- Certified copy of the corporation's current certificate of incorporation or registration or the equivalent document;[2]
- Certified copy of the corporation's constitution (memorandum and articles of association, or their equivalent);[3]

2 The certificate must be certified as a true copy by the corporate authority in the company's place of incorporation which exercises functions similar to those of the Australian Securities Commission. The certification should be dated no earlier than three months before the copy is lodged with the Australian Securities Commission, unless an extension has been granted.

3 The document can either be an up-to-date copy embodying all alterations or a copy of the original document, together with copies of all resolutions altering or affecting the memorandum or articles. The document must be certified by the appropriate authority as a true copy.

- If there are registerable charges over assets of the company, for each charge, a notification of details of the charge and, where applicable, certification of compliance with stamp duties law (and associated documents);[4]
- If the list of directors on the application form includes directors who are resident in Australia and members of a 'local board' of directors, a memorandum executed by or on behalf of the foreign company, stating the powers of those directors; and
- Memorandum of appointment of local agent or power of attorney in favour of such local agent.[5]

If the memorandum of appointment of a local agent or power of attorney is executed on behalf of the foreign company, a copy of the document authorising the execution of the document appointing the local agent verified as a true copy also must be lodged.

Lodging Form and Documents with Prescribed Fee. The application for registration as a foreign company must be signed by a local director or agent, a director, or secretary of the company acting as an agent and lodged with the prescribed fees.

Post-Registration Obligations

Displaying Registered Name. A foreign company must display its name in a conspicuous position and in legible characters outside every office and place of business. It also must display in a like manner its place of origin, the expression 'registered office' at its registered office and, if the liability of the members is limited and the last word of its name is either 'Limited' or 'Ltd', notice of that fact.

Australian Registered Body Number. Every foreign company will receive on registration a unique nine-digit identification number, known as the 'Australian Registered Body Number'. The name of the company, in legible characters, followed by the expression 'Australian Registered Body Number' (or a permitted abbreviation such as 'ARBN'), and the number itself must appear on:

- Every public document issued, signed, or published by, or on behalf of, the company;
- Every eligible negotiable instrument signed or issued by, or on behalf of, the company; and
- All documents required to be lodged with the Australian Securities Commission.

In addition, every public document issued, signed, or published by, or on behalf of, the company must include in legible characters its place of origin and, if applicable, that the liability of the members is limited. The Australian Securities Commission, however, does allow some abbreviations to be used in relation to this (eg, 'Aust', 'Co', and 'No').

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4 The documents required to be lodged must meet specific statutory requirements.

5 This document must be executed by or on behalf of the foreign company (usually under common seal) and state the name and address of the local agent, who is a natural person or company, a resident in Australia, and is authorised to accept, on behalf of the foreign company, service of process, and notices.

Financial Statements. A registered foreign company is required to lodge with the Australian Securities Commission at least once every calendar year and, at intervals of no more than 15 months, a copy of its balance sheet and profit-and-loss account. These must be made up to the end of the last financial year, together with any other documents that the company is required to prepare by laws applicable in the foreign company's place of origin and, where the company is listed, any documents required by the Australian Stock Exchange Limited.

Exempt Foreign Companies. If a registered foreign company falls within the specific types of foreign companies that have been declared by the Australian Securities Commission to be exempt foreign companies and has appointed an auditor, it may be eligible to lodge an annual return and a copy of an auditor's report in lieu of financial accounts. Australian Securities Commission Policy Statement 58 outlines circumstances in which the Australian Securities Commission:

- Exercises its discretionary powers to declare that the lodgement of annual accounts does not apply to specified registered foreign companies;
- Will give large proprietary companies in which a foreign company has a direct or indirect interest relief in the requirement to lodge financial statements; and
- Provide relief to small proprietary companies which are controlled by foreign companies.

Generally, the Australian Securities Commission may not give relief to a registered foreign company carrying on business in Australia if the relief means that the registered foreign company would lodge less information than equivalent Australian companies.

Notice of Changes. A registered foreign company must lodge a written notice with the Australian Securities Commission within one month of a change of:

- Its name;
- Its constitution;
- Its directors;
- Its local agent (or the name or address of a local agent);
- The powers of any directors who are resident in Australia and members of an Australian board of directors; and
- The address of its registered office in its place of origin (if any) or principal place of business in its place of origin.

Furthermore, a registered foreign company must lodge with the Australian Securities Commission written notice within seven days of:

- A change in the situation of its registered office address in Australia; and
- Its ceasing to carry on business.

It also must lodge notice with the Australian Securities Commission within one month if it is wound up or dissolved in its place of incorporation or origin. Charges on property or assets of a registered foreign company also may must be registered.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. The domestic exchanges that are actively trading in the securities of listed public companies in Australia are the Australian Stock Exchange Limited and, in relation to futures contracts, the Sydney Futures Exchange. These two bodies have been previously mentioned.

Transborder Electronic Trading Systems. Most on-market transactions in Australia by participants and investors are undertaken by a broker by placing an order to buy securities for a buying client with the buying broker. A market order requires the buying broker to execute the order promptly at the best available price. A limit order requires the broker to buy at or below or sell at or above a stated limit price. The buying broker makes a contract with the selling broker by means of the Stock Exchange Automated Trading System (SEATS) without either broker disclosing the identity of its client.

Under the SEATS system, bids and offers are entered, transactions are executed, and off-market trades are reported at SEATS terminals. Orders are automatically executed against bids or offers within parameters defined by the highest bid and lowest offer. Trading occurs according to predetermined rules as to priority. If the buying broker holds orders to purchase a particular security from several clients, the broker will generally seek to make purchases and allocate securities to the clients in the sequence in which the orders were received. However, the broker may need to exercise a discretion in allocation if some orders were subject to price limits which restricted their execution. That allocation will be made on the day on which the transaction occurred on SEATS.

The buying broker will then send a contract note to the buying client which contains details of the securities purchased, the price, and brokerage charges that apply to the purchase, and which requests payment by the client. The buying broker is obliged to pay the purchase price for the securities within the time limits set under the Australian Stock Exchange Business Rules, whether or not the buying broker has received payment from the buying client. If payment has not been received from the buying client at that point, the buying broker will make payment for the securities from its general account.

In Australia, the Clearing House Electronic Sub-Register System (CHESS) provides an electronic sub-register for uncertified holdings of a number of classes of CHESS-approved securities. Each CHESS sub-register is administered by the Securities Clearing House (Securities Clearing House) and forms part of the issuer's relevant securities register for the purpose of the Corporations Law.

This electronic sub-register facilitates the registration of transfers of securities. In the paper environment, transfers are registered by the issuers securities registry on delivery of paper transfer and (except where the securities are held in uncertified form) the relevant security certificate. This obviously results in a delay between settlement of a transaction and registration of a transfer to reflect the transaction. The CHESS sub-register, however, is electronically linked to the issuer and CHESS participants, with the consequence that,

for all practical purposes, delay between settlement and registration is eliminated. Information regarding CHESS subscription is obtained through the Australian Securities Commission.

Role and Legal Position of the Securities Clearing House. Part 7.2A of the Corporations Law deals with the approval of a body corporate known as the

Securities Clearing House. The Corporations Law sets out a procedure for application and authorises the Minister to approve the applicant as the Securities Clearing House if the Minister is satisfied with certain matters.[6]

The Minister must be satisfied that the applicant's business rules have satisfactory provisions about facilities for settlement and transfer and any other facilities which the applicant proposes. The business rules also must include satisfactory provisions about the disciplining of Securities Clearing House participants or members.

Every foreign entity listed on the Australian Stock Exchange Limited, whether as an exempt foreign entity or through general admission, must establish and maintain in Australia an Australian securities register (or sub-register), a register of depositary receipts, or other appropriate facilities for the registration of transfers. The Australian Stock Exchange Limited operates a fully computerised system for the electronic transfer of uncertificated securities. This system is called CHESS, as described above. Every entity must comply with CHESS requirements unless it is precluded from participating by the jurisdiction in which it is established.

The Australian Stock Exchange Limited encourages foreign entities established in jurisdictions that preclude direct participation in CHESS to use other means to facilitate electronic clearing and settlement of transactions in their securities. The Australian Stock Exchange Limited can provide depositary instruments that allow transactions in the securities of exempt foreign entities to be cleared and settled through CHESS. These instruments are called CHESS Units of Foreign Securities (CUFS). Depositary instruments issued by third parties also may be used to allow transactions to clear and settle through CHESS.

Off-Market Transactions. Due to restrictive provisions in the Corporations Law and Australian Stock Exchange Listing Rules with respect to the trading of securities in listed companies and requirements placed on brokers and securities advisors, off-market transactions dealing with securities of a listed company that are insignificant. As such, this chapter does not address this issue. However, set out below is a summary of a new innovation by the Australian Stock Exchange Limited for the raising of capital by smaller non-listed companies which has the potential to have a significant impact in the future if embraced by the market.

Australian businesses have historically had problems raising equity capital. The Australian Stock Exchange Limited has developed an innovative solution to this problem which was expected to be implemented in the first quarter of 1998 and called the Enterprise Market. The Enterprise Market is an Internet-based capital market available to any non-listed

6 Corporations Law (Cth), s 779B.

entity wishing to raise capital. It may be a proprietary company, unlisted public company, partnership, joint venture, trust, or co-operative. Under certain circumstances, it also may be a proprietary subsidiary of a publicly listed company.

The Enterprise Market will utilise the very latest in Internet technology to deliver capital market for non-listed businesses which will hopefully become a model for future markets throughout the world.

There are approximately 10,000 non-listed businesses in Australia which have between one and 250 employees (small and medium-sized enterprises), and there has been a reluctance by these businesses to make the move from debt to equity capital. The Australian Stock Exchange Limited has determined that these small and medium-sized enterprises are looking to raise approximately Aus $500,000 each, representing an Aus $5 billion market. The Enterprise Market will have subscribers who will pay access fees. Subscribers will principally comprise:

- Companies that are looking for equity capital;
- Existing investors in non-listed companies who want to sell their shares;
- Investors who are looking for venture capital investors;
- Those who are acting for one of these parties; and
- Experts prepared to certify information provided by sellers.

An important aspect of the market is that both buyers and sellers have the choice to be anonymous. Using the Enterprise Market as a mechanism for capital-raising provides a general exemption from the prospectus requirements of the Corporations Law during that phase of the capital-raising process when investors are being identified. The Enterprise Market will provide a way of providing detailed information about a business to a wide variety of potential investors and advisers without requiring a formal prospectus.

Securities

National Treatment and Reciprocity. The Corporations Law defines 'securities' to mean:

- Debentures, stocks, or bonds issued or proposed to be issued by government;
- Shares in, or debentures of, a body; and
- Prescribed interests.[7]

Units of shares or prescribed interests also fall within the definition. The term 'unit' is defined in section 9 of the Corporations Law as including the right of interest, whether legal or equitable, in a share and option to acquire such a right or interest. It is arguable that the concept of a unit of shares in a body corporate is limited to options to acquire a right or interest in an issued share at a future time and does not include actions over unissued shares. Finally, the term 'securities' includes an option contract, but it does not

7 Corporations Law (Cth), s 92(1).

include futures contracts and 'excluded securities'. The term 'excluded security' is defined in section 9 as:

- A share or debenture or a unit in a share or debenture where a right to participate in a retirement village is attached to the share debenture and where each of the other rights and any interest attached to the share or debenture is merely incidental to the right to participate in the retirement village scheme; or
- A prescribed interest constituted by a right to participate in a retirement village scheme.

In effect, the exclusion of 'excluded securities' from the definition of the term 'securities' in section 92 removes interest in retirement villages from the scope of regulation under chapter 7 of the Corporations Law. It is important to note that the inclusion of prescribed interests within the definition of 'securities' in section 92(1) extends the scope of the definition significantly, and it includes items which would not traditionally be characterised as securities. In particular, the term 'prescribed interest', operating through the definition of a 'participation interest', includes interest in a unit trust.

'Prescribed Interest' is defined in section 9 as a 'participation interest' or 'a right, whether enforceable or not, whether actual, prospective or contingent and whether or not evidence by a formal document, to participate in a time sharing scheme'. A major feature of the Corporations Law requiring use of a prospectus is the offer to the public criterion. Whenever an offer or invitation to subscribe for securities is made, a prospectus is required unless that offer or invitation is expressly exempt. In the event that the prospectus is required, it generally must be:

- Prepared in accordance with the content requirements of the Corporations Law;
- Lodged with the Australian Securities Commission;
- Registered by the Australian Securities Commission except in certain circumstances; and
- Issued, in the case of debenture and prescribed interest prospectuses, only in compliance with certain additional requirements.

The Corporations Law seeks to strike a balance between the need of potential investors for access to material information about an investment opportunity and the need to ensure that transactional costs in raising investment capital are not unreasonably disproportionate to the public benefits achieved by a mandatory disclosure document. Listed below are the broad prohibitions.

Issuer Requirements. A foreign issuer of securities would be required to be registered with the Australian Securities Commission as a foreign body prior to issuing any securities. Registration in Australia as a foreign body has been dealt with earlier. In addition, where the issuer requires its securities to be publicly traded, such foreign entity will be required to list on the Australian Stock Exchange Limited. This also will require the use of a prospectus and its lodgement with both the Australian Securities Commission and Australian Stock Exchange Limited.

An issue of securities in Australia not leading to listing on the Australian Stock Exchange Limited or a further issue of securities in Australia by a foreign entity also may require the

lodgement of a prospectus with the Australian Securities Commission and Australian Stock Exchange and possibly the registration of that prospectus. This will be dealt with later in this chapter.

Listing on Australian Stock Exchange. There are two ways in which a foreign entity may list on the Australian Stock Exchange Limited. The first is a primary or secondary listing under the usual or general entry requirements (ie, general admission) of the Australian Stock Exchange Limited; the second is as an exempt foreign entity, which would involve a secondary listing on the Australian Stock Exchange Limited.

General Listing. A company wishing to be generally listed on the Australian Stock Exchange must demonstrate financial strength by satisfying either the profit test or the net-tangible-assets test. Under the profit test, there must have been:

- Aggregate profit for last three years of at least Aus $1 million;
- Consolidated profit for the last 12 months of more than Aus $400,000; and
- No change in main business activity in the last three years.

The applicant must provide audited financial statements for the last three years prepared in accordance with Australian Accounting Standards and a pro forma balance sheet post-listing, reviewed by an auditor or independent accountant.

Under the net-tangible-assets test, net tangible assets of at least Aus $2 million are required; there must be sufficient working capital and the likelihood to generate profit within three years from listing. The applicant must provide financial statements (not necessarily audited) for three years before listing[8] and a *pro forma* balance sheet post-listing, reviewed by an auditor or independent accountant.

Where the company to be listed is a mining exploration company, investment company, or scientific research company, the net-tangible-assets test is varied to take into account the different nature of those companies.

There must be at least 500 shareholders, each with at least Aus $2,000 worth of shares. This requirement ensures that there is sufficient interest in the entity to justify listing and aids liquidity. There is no requirement for a minimum number of Australian resident security holders. However, the Australian Stock Exchange Limited encourages foreign entities seeking primary listing to obtain and maintain a sizeable and diverse security holding base in Australia. The Australian Stock Exchange therefore encourages entities seeking a primary listing to have at least 300 Australian resident security holders, each holding a parcel of securities with a value at the time of listing of at least Aus $2,000.

It is important to note that the Australian Stock Exchange will not accept security holdings obtained by artificial means when assessing an entity spread of an entity's security holdings. For example, the Australian Stock Exchange Limited regards as

8 If the financial statements have not been audited an audit report for the most recent balance sheet.

s artificial the giving away of securities, offering non-recourse loans to prospective purchasers to acquire them, or using combinations of nominee companies as shareholders. The securities issued by the company must:

- Be ordinary shares, unless the Australian Stock Exchange otherwise approves;
- Have a par value of at least Aus $0.20; and
- Have equal voting rights.

The following general requirements also apply:

- In the view of the Australian Stock Exchange, the company must be suitable for listing;
- The foreign company is required to be registered as a foreign company with the Australian Securities Commission;
- The Australian Stock Exchange Limited must approve the memorandum and articles of association of the company, as the constitution of the foreign entity seeking a general admission listing must be consistent with the Corporations Law and with the Australian Stock Exchange Limited Listing Rules;[9]
- The company must have lodged a prospectus with the Australian Securities Commission, the Australian Stock Exchange Limited then reviewing it to see if it complies with the Listing Rules and that there is enough information available to allow trading of the securities;
- While the Australian Stock Exchange Limited does not review draft prospectuses, it does consider information of a more general nature before a prospectus is registered with the Australian Securities Commission;[10]
- Any shares issued in relation to the formation of the company, in return for selling assets to the company or the company's listing, must be held in escrow for at least two years;
- The company must have a share registry in Australia; and
- Just as with Australian companies, the Australian Stock Exchange Limited may require some securities of a foreign entity seeking a general admission to be 'restricted securities'.[11]

By way of general comment, a foreign entity seeking a primary listing on the Australian Stock Exchange Limited often benefits by having directors in offices resident in Australia. The Australian Stock Exchange encourages at least one Australian resident director, and

9 As part of the entity's application, it must complete a checklist to indicate compliance of its constitution with Australian Stock Exchange Listing Rules. It must identify any differences between a requirement and its jurisdiction for its constitution and Australian requirements when it applies to listing.

10 The Corporations Law sets out requirements for prospectuses. The Australian Stock Exchange Limited does not stipulate what information should be included in a prospectus and expert reports. That decision must be made by the entity and others involved in the preparation of the prospectus. The Australian Stock Exchange Limited, however, does require that a foreign entity seeking primary listing has an Australian resident among those accepting responsibility for the prospectus. This is usually satisfied by having an Australian resident director. The Australian Stock Exchange Limited may require that additional information is disclosed to the market before quoting the securities of the newly admitted entity to secure an informed secondary market.

11 Restricted securities are held in escrow for a specified period. This prevents the transfer of effective ownership or control of them. There are specific guidelines and Listing Rules applying to restricted securities.

an Australian resident company secretary or assistant company secretary. Even if a foreign entity seeking a general admission listing on the Australian Stock Exchange does not need to appoint an Australian agent to lodge documents and reports, the Australian Stock Exchange encourages it to do so as it is important for an entity to be seen to be close to the primary market for its securities and an Australian representative helps achieve this.

Exempt Foreign Entities. A secondary listing will occur if the entity is to be classified as an exempt foreign entity. Entities already listed on another stock exchange with a significant profit history or significant net tangible assets, and entities already listed on the New Zealand Stock Exchange may be eligible to apply in this category. Many of the Australian Stock Exchange's ongoing Listing Rules do not usually apply to exempt foreign entities. Specific admission requirements include:

- The entity must be a member of the Fèdèration International des Bourses de Valeurs at its overseas home exchange and be subject to and comply with the Listing Rules (or their equivalent) of that home exchange;
- The entity must have at least Aus $10 million operating profit before tax for each of the last three years or have net tangible assets of at least Aus $50 million;[12]
- There must be at least 1,000 holders, each having a parcel of securities (in the class for which the entity) with a value of at least Aus $500;[13]
- If the entity is a foreign company under the Corporations Law (as discussed above), the entity must be registered as a foreign entity;
- The entity must apply for and be granted 'securities in a class for which it seeks';[14] and
- An application form must be completed, and the Australian Stock Exchange must be given a copy of the entity's last annual report and any subsequent interim report.[15]

There also are a number of continuing requirements for an exempt foreign entity after it is listed on the Australian Stock Exchange. An exempt foreign entity, however, is not subject to a large portion of the Australian Stock Exchange's Listing Rules. The continuing requirements include providing to the Australian Stock Exchange in English all information it provides to its overseas home exchange that is, or is to be, made public; and continuing to comply with:

- The listing rules of its overseas home exchange;

12 Entities whose home exchange is the New Zealand Stock Exchange do not need to meet this requirement.

13 Entities whose home exchange is the New Zealand Stock Exchange do not need to meet this requirement.

14 The entity may apply for 'all securities in the class'. Entities with the New Zealand Stock Exchange as their home exchange must apply for and be granted 'of all securities in the class for which' on the Australian Stock Exchange Limited is sought.

15 The application form requires the entity to provide detailed information about itself (including a copy of its constitution, ie, memorandum and articles of association, or equivalent), a brief history, and a brief description of the regulatory regimes to which it is subject on its overseas home exchange and in its jurisdiction of incorporation or establishment.

- The Listing Rules relating to transfers and registers of securities, ie, no interference with transfers,[16] maintaining registers in Australia,[17] accepting transfer markings by persons approved by the Australian Stock Exchange,[18] and time limits;[19] and
- The Listing Rules relating to procedural and administrative matters, including the way announcements are lodged; trading halts, suspension, and removal; the application of the Listing Rules; and the interpretation and definitions.

The Exemption: New Zealand Companies. If a New Zealand company listed on the New Zealand Stock Exchange wishes to list on the Australian Stock Exchange, it is not required to comply with either the profit or net-tangible-assets test. The only requirements for listing such a company are:

- The company must be subject to the Listing Rules of New Zealand Stock Exchange and have a history of compliance with those rules;
- The company must give the Australian Stock Exchange a copy of its latest annual report, together with other information regarding the company's history;
- The company must establish an Australian share registry; and
- The company must quote all of the shares which are listed on the New Zealand Stock Exchange on the Australian Stock Exchange.

If the New Zealand company is not listed on the New Zealand Stock Exchange, it will need to comply with either the profit or the net-tangible-assets test and all the other requirements listed above. A New Zealand company which is listed on the New Zealand Stock Exchange and the Australian Stock Exchange Limited is not required to comply with all Australian Stock Exchange Limited Listing Rules. The New Zealand company would be required to comply with certain Listing Rules, such as giving the Australian Stock Exchange a copy of all documentation given to the New Zealand Stock Exchange. The company would not be required to lodge with the Australian Stock Exchange half-yearly and annual reports. It also would need to prepare its accounts in accordance with Australian or International Accounting Standards. Finally, a New Zealand company, whether listed on the New Zealand Stock Exchange or not, will be required to be registered in Australia as a foreign company under the Corporations Law.

Other Provisions of Note. If a foreign entity with a general admission listing on the Australian Stock Exchange is considering a significant change to the nature of scale of its activities, it must consult the Australian Stock Exchange, and it may be required to meet the admission and quotation Listing Rules in its restructured form as if it were seeking admission to the Official List again. A meeting of the entities security holders to approve the change to activities also may be required.

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16 Australian Stock Exchange Listing Rules 8.10.
17 Australian Stock Exchange Listing Rules 8.15.
18 Australian Stock Exchange Listing Rules 8.18.
19 Australian Stock Exchange Listing Rules, Appendix 8A.

Some foreign jurisdictions restrict the listing of their domestic entities on foreign exchanges. An entity incorporated or registered in one of these jurisdictions seeking to list on the Australian Stock Exchange should obtain any necessary approvals before applying to be listed on the Australian Stock Exchange and provide the Australian Stock Exchange with evidence of the approval in making its application.

Prospectus Requirements. Pursuant to section 1018 of the Corporations Law, a company is prohibited from offering for subscription, or issuing invitations written or oral to subscribe for, securities of a corporation (in due form) unless a prospectus is lodged with the Australian Securities Commission and, where required, registered with the Australian Securities Commission. It is important to realise that this prohibition applies to all offers or invitations to subscribe for securities, irrespective of how the offer or invitation is conveyed.

The Australian Securities Commission has indicated that section 1018 of the Corporations Law applies to offers or invitations made in Australia only. An offer or invitation is made in Australia if it is received by the offeree or invitee in Australia. Section 1018 does not have extraterritorial effect. The following can be said of offers or invitations made by a foreign company or an offer or invitation made outside of Australia:

- A primary offering solely made outside Australia by an Australian or foreign company will not require a prospectus in relation to the offering or invitation for the purposes of Australian law. However, if these securities (the subject of the offer or invitation) are to be listed on Australian Stock Exchange then a prospectus is required to be lodged and registered before listing is sought.
- A primary offering solely or partly made in Australia by a foreign company will require a prospectus to be lodged with the Australian Securities Commission unless the offer or invitation is excluded under the Corporations Law.

Offers or Invitations in Secondary Trading. Until 4 September 1994, section 1018 applied to offers and invitations to buy securities already issued. On 4 September 1994, amendments to division 2, part 7.12, of the Corporations Law came into effect so that now secondary trading in quoted securities (ie, those already listed on the Australian Stock Exchange) do not need any disclosure through a prospectus or similar document other than that required of the corporation by the continuous disclosure regime of the Australian Stock Exchange Listing Rules.

Different rules will apply for secondary trading of unquoted securities, depending on whether the sale is less or greater than 30 per cent of the issued capital of the entity.[20]

Specific Exemptions. The Corporations Law provides a number of specific exemptions from the requirement to use a prospectus when issuing securities. The exemptions are intended to ensure that the efficient operation of the securities markets in Australia is

20 Corporations Law (Cth), division 3A, part 7.12.

not unreasonably impeded by onerous requirements. These exemptions generally relate to small-scale securities sales, campaigns, transactions in issued stock exchange quoted securities, and offers which are confined to persons who may reasonably be thought to be able to make an investment decision without the aid of a prospectus.

In essence, if the issue is an 'excluded issue' or 'excluded offer or invitation', as defined under section 66 of the Corporations Law, a company including a foreign company is not required to issue a prospectus. Some of the issues, offers, or invitations of securities which are regarded as an 'excluded issue' or 'excluded offer or invitation' are as follows:

- The amount subscribed for the securities by each person to whom the securities are issued or allotted is at least Aus $500,000, or offers or invitations to subscribe for at least Aus $500,000 by each person to whom the offer is made or invitation is issued;
- The securities are issued or allotted to an underwriter under an underwriting agreement;
- No consideration is paid or provided in respect of the issue or allotment;
- Securities of the same class are issued or allotted to no more than 20 persons in any consecutive 12-month period as a result of each of those persons accepting an offer or invitation which had been issued or made personally to them;
- The securities are issued or allotted to an executive officer of the issuing corporation, or any of its related bodies corporate; any close relative of such an executive officer; or body corporate in which such executive officers, or their close relatives, have a controlling interest;
- The securities are rights or interests in a superannuation fund constituted by or under a local or foreign law or are debentures of an excluded corporation;
- The securities are issued or allotted by a listed corporation pursuant to the exercise of an option grant pursuant to a prospectus;
- Shares are issued to a person by a listed corporation under a provision contained in a convertible note, whether the note was issued by that corporation or by another body corporate;
- Debentures, other than convertibles notes, of a corporation are issued to the holders of existing debentures (other than convertible notes) of that corporation;
- Convertible notes are issued by a corporation to existing holders of convertible notes issued by that corporation; and
- It is specifically declared by regulation to be an excluded issue.

Contents of Prospectus. In addition to a limited number of other specified matters which must be included in a prospectus, section 1022 of the Corporations Law provides that a prospectus must contain all such information as investors and their professional advisors would reasonably require and reasonably expect to find in the prospectus for the purpose of making an informed assessment of:

- The assets and liabilities, financial position, profits and losses, and the prospects of the company; and
- The rights attaching to the securities being offered.

In determining the information to be included in the prospectus, regard also must be given to issues such as the nature of the securities, the kind of person likely to consider investing in the securities, the fact that certain matters are already known by professional advisers and investors, and whether investors have previously been supplied with information. As a basis, the following information would typically be included in a prospectus:

- The company's capital structure, directors, and management;
- The proposed use of the funds;
- The company's material contracts;
- The risks, including any particular credit risks associated with investing in the company;
- An investigating accountants report, including historical audited financial results, *pro forma* balance sheet reflecting the financial position of the company following the issue, and justification of any profit forecasts; and
- The economic, political, and legal environment in which the company operates.

Registration of Prospectus. Once a prospectus has been completed and signed by the directors of the issuing company, the prospectus must be registered with the Australian Securities Commission, together with an application for it to be registered under section 1020A of the Corporations Law. The application should request registration under the Corporations Law rather than under the Corporations Law of a particular jurisdiction. This ensures that, once registered, it will be treated as a valid prospectus throughout Australia.

Although after a prospectus is lodged the Australian Securities Commission has 14 days to consider whether to register or refuse to register it, as a matter of practice, the Australian Securities Commission aims to confirm registration of prospectus within three days of lodgement. Once a prospectus has been registered, a company is free to offer securities for a period of up to 12 months after the date of issue of the prospectus.

Multinational Offerings. A number of foreign companies will require multinational securities offerings. It is vital that a thorough due diligence program is implemented with the effect of minimising the potential criminal and civil liability that could arise if the prospectus is deficient. The main liability provisions arising under the Corporations Law are section 995, which prohibits a person from engaging in conduct that is misleading and deceptive are likely to mislead or deceive, and section 996, which provides that a person must not authorise or cause the issue of a prospectus in which there is a material statement that is false and misleading or from which there is a material omission.

Criminal liability extends to persons who authorise or cause the issue of a deficient prospectus. To establish a due diligence defence against such liability, a party must establish a due diligence committee, create checklists, and verify statements. Section 1030 of the Corporations Law deems any document issued by a corporation to be a prospectus that allots, or agrees to allot or issue, its securities for the purpose of being offered for on-sale by any person. The prospectus liability provisions attach to such documents.

Applying for Listing. If a prospectus refers to the company seeking listing on the Australian Stock Exchange, an application for listing must be made within three days of the date of issue of the prospectus. If permission for the listing is not granted within six weeks of the date of issue (or such longer period, not exceeding 12 weeks, as is notified with the Australian Stock Exchange), any allotment of securities pursuant to the prospectus is void, and the company must repay any subscription monies received.

Corporate Governance. Corporate governance is the system by which companies are controlled. The Australian Stock Exchange requires listed entities to adopt appropriate corporate governance practices. At the same time, the Australian Stock Exchange recognises that certain governance practices may be appropriate for particular types of listed entities but not for others.

The Australian Stock Exchange Listing Rules require entities to provide details of their corporate governance practices in their annual report. To assist entities, an indicative list of corporate governance matters has been included as an appendix to the Australian Stock Exchange Listing Rules. Examples of such matters include the main procedures for establishing and reviewing the compensation arrangements for board members and senior executives and the main procedures for the nomination of external auditors in reviewing the adequacy of existing external audit arrangements.

There are a number of corporate publications that may assist listed entities that are examining their corporate governance practices. These include *Corporate Practices and Conduct* (November 1995), produced by the working group on corporate practices and conduct and *Corporate Governance — A Guide for Investment Managers and Statement of Recommended Corporate Practice* (June 1995), produced by the Australian Investment Managers Association. The Australian Institute of Company Directors has recently published a code of conduct for company directors. The Australian Stock Exchange expressly supports the activities of the Institute in enhancing the awareness of professional knowledge of directors.

Periodic Disclosure

Official and Regulated Market

In General. The Australian Stock Exchange Listing Rules provide for continuous disclosure by all listed entities. Australian Stock Exchange Listing Rule 3.1 states:

> Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell Australian Stock Exchange that information. This rule does not apply to particular information while each of the following applies:
>
> 3.1.1 A reasonable person would not expect the information to be disclosed.
>
> 3.1.2 The information is confidential.

> 3.1.3 One or more of the following applies:
>
> (a) It would be a breach of a law to disclose the information.
> (b) The information concerns an incomplete proposal or negotiation.
> (c) The information comprises matters of supposition or is insufficiently definite to warrant disclosure.
> (d) The information is generated for the internal management purposes of the entity.
> (e) The information is a trade secret.

The Rule applies to all listed entities except exempt foreign entities. Exempt foreign entities were discussed earlier. The word 'aware' is defined in the Australian Stock Exchange Listing Rules as follows:

> An entity becomes aware of information if a director or executive officer (in the case of a trust, a director or executive officer of the management company) has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as a director or executive officer of that entity.

The definition of 'aware' in the Australian Stock Exchange Listing Rules is based on a similar provision in the Corporations Law; however, it is narrower in that the test is limited to directors and executive officers and does not extend to employees generally. An executive officer is a person concerned in, or taking part in, the management of the company. Compliance with the Australian Stock Exchange Listing Rule 3.1 is the responsibility of the entity and, for this reason, appropriate systems should be considered to identify material information and decide about disclosure of that information. The Australian Stock Exchange's continuous disclosure regime is supported by the following principal:

> Timely disclosure of information must be made which may affect security values or influence investment decisions, and information in which security holders and investors in Australian Stock Exchange have a legitimate interest.

The continuous disclosure rules are particularly important and apply to all listed entities except exempt foreign entities. Debt issuers must comply with the continuous disclosure rules in relation to their debt securities.

Obligation to Disclose. The language of the obligation to disclose under Listing Rule 3.1 is similar to the language used in section 1001A of the Corporations Law. An entity must disclose information if a reasonable person would expect that information to have a material effect on the price or value of the securities. A reasonable person is taken to expect information to have a material effect on the price or value of securities if it would, or would be likely to, influence persons who commonly invest in securities in

deciding whether or not to subscribe for, buy or sell the securities. In *Flavel* v *Roget*,[22] O'Loughlin J said:

> Much will depend on the identity of the particular company; what one company should advise the Stock Exchange might not need to be advised
>
> by a second company; what should be advised by a company at one stage in its career might not need to be advised at another stage of its career because of changed circumstances.

Other Requirements. Entities must disclose information needed to prevent a false market, ie, they may be required to confirm or correct rumours. The fact that information is generally available is not an excuse for failing to disclose. An entity may not release information which is for release to the market to any person (including the media, even on an embargoed basis) until it has given the information to the Australian Stock Exchange Limited and received an acknowledgement that the Australian Stock Exchange Limited has released it to the market. There are 'out-of-hours' exceptions to this.

The entity must disclose material information of which it is aware has come from any source and must take into account its interests in other entities. The information to be disclosed is information concerning the entity, however, if general information has a particular effect on the entity (eg, a lower gold price means that the entity can no longer economically operate a mine) that should be disclosed.

Exceptions. Under Listing Rule 3.1.1, a reasonable person would not expect information to be disclosed if the result would be an unreasonable prejudice to the entity; the Australian Stock Exchange Limited will balance the needs of the market and the interests of the entity. For this reason, an inordinate amount of detail is not expected.

Under Listing Rule 3.1.2, the second requirement of the exception is that the information is confidential. 'Confidential' in this context has the sense of secret, and it generally implies control by the entity of the use that can be made of the information, ie, it means that no one in possession of the information is entitled to trade in the entity's securities. Entities are not entitled to rely on the exception just by entering into confidentiality arrangements if the other two requirements are not satisfied.

The Australian Stock Exchange Limited accepts that confidentiality is not breached if information is given to an entity's advisers, a person the entity is negotiating with, or other regulatory authorities, if it is be given on a basis that restricts its use to the stated purpose.

Other Announcements. Other announcements that may be necessary include:

- Interim announcements in the event of delays to the possibility of detailed disclosure;[23]

22 *Flavel* v *Roget* (1990) 1 *Australian Company and Securities Reports* 595, at pp 602 and 603.
23 An insufficient announcement may result in a trading halt.

- Speculation responses;
- Shortfall or over-subscription information regarding underwriting;
- Analysts reports;
- Provision of information to the Australian Stock Exchange Limited no later than the time that it is given to the overseas market; and
- Additional accounting information or accounting forms, as may be necessary for the market to be properly informed.

Enforcement of Listing Rule Disclosure Requirements

Section 1001A of the Corporations Law imposes statutory liability for certain breaches of Listing Rule 3.1. Furthermore, the credibility of the market is enhanced if continuous disclosure is carried out in the 'spirit' of the Listing Rules and, for this reason, the continuous disclosure Listing Rules relating to publicly listed companies are not interpreted in a restrictive or legalistic fashion.

Post-Listing Requirements

Financial Reports. Periodic disclosure of financial information is required. This is in the form of:

- Half-yearly reports, within 75 days of the end of any accounting period;
- End-of-year or annual report, within 75 days of the end of year accounting period; and
- Copies of all annual financial statements which are required to be lodged with the Australian Securities Commission.

One sanction imposed by the Australian Stock Exchange on an entity that fails to meet reporting deadlines is that the quotation of its securities will be suspended until the required reports have been given to the Australian Stock Exchange. It is therefore important that foreign entities with a general admission listing on the Australian Stock Exchange have staff with the accounting skills (including expertise in the Australian accounting standards used) necessary to ensure that the Australian Stock Exchange's ongoing reporting requirements are met. Generally, the Australian Stock Exchange will accept international accounting and auditing standards.

For historical financial statements provided in relation to an application by a foreign company for a primary listing, an Australian accounting firm must confirm that the audit methodologies used closely conform to Australian, international, or other standards acceptable to the Australian Stock Exchange.

General Compliance. The foundation for the Listing Rules is to ensure that the market for shares is fully informed of the company's operations. The Listing Rules regulate such matters as:

- Share issues of more than 10 per cent of the total capital in any one year without obtaining prior shareholder approval;
- Share buy-backs;

- Employee share incentive schemes;
- Related party transactions; and
- Significant changes to the nature or scale of activities.

Additionally, the Australian Stock Exchange must be notified of and, in some cases, approve:

- Proposed constitution of the company and amendments;
- Documents sent to a person to participate in a new issue of shares;
- Documents sent to shareholders seeking their approval under the Listing Rules; and
- Issues of shares and changes to the registered office or auditor.

To maintain the company's listing, a company must:

- Comply with the Listing Rules;
- Maintain a strong financial position;
- Not allow half or more than half of the company's total assets to be in cash or in a form readily convertible to cash; and
- Maintain a sufficient spread of shareholders to ensure that there is an orderly and liquid market.

Trading Rules

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties. Under part 6.7 of the Corporations Law, any person with a substantial shareholding in the voting shares of a listed company is required to give notice of that shareholding to the company and the Australian Stock Exchange within two days of reaching that limit.

In general terms, a person is a substantial shareholder by virtue of being entitled to more than five per cent of the voting shares of a company.[24] Shares to which a person is entitled include shares in which the person or an associate (widely defined) has a relevant interest.[25] 'Associates' include related bodies corporate, directors, and persons acting with a common interest. A person has a relevant interest in a voting share in a company if that person has the power to:

- Exercise, or to control the exercise of, the right to vote attached to that share; or
- Dispose of, or exercise control over, the disposal of that share.

It is important to note that the power or control includes a reference to power or control that is direct or indirect or which is exercisable as a result of, or even in breach of, an arrangement or understanding, whether enforceable or not.

Furthermore, it is possible to have a deemed entitlement to shares. If an agreement is entered into between two parties relating to shares in which one of the parties holds a

24 Corporations Law (Cth), s 708.
25 Corporations Law (Cth), s 609(1).

relevant interest, the other party will be deemed to be entitled to the shares that are the subject of the agreement. The effect of the substantial shareholder provision is that it is difficult for a predator to acquire a holding of between the five per cent and the 20 per cent take-over threshold without the target company's knowledge prior to a formal bid. Section 718 also enables a company or shareholder to require a nominee shareholder in the company to disclose for whom it is acting.

It is also important to note that the provisions of the Corporations Law dealing with notification of substantial shareholdings and take-overs do not apply to companies established outside of Australia. The Australian Stock Exchange has introduced measures to protect investors and ensure that the market is properly informed. For example, a foreign entity with its primary listing on the Australian Stock Exchange is required to include in each annual report a prominent statement about each of the following matters:

- Its place of incorporation or registration;
- That it is not subject to chapter 6 of the Corporations Law, which deals with the acquisition of shares (ie, substantial shareholdings and take-overs); and
- Any limitations on the acquisition of securities imposed by the jurisdiction in which it is incorporated or registered.

Entities should consider including similar statements in any prospectus or information memorandum may issue. The Australian Stock Exchange usually requires a foreign entity with a general admission listing to undertake to give adequate information to the Australian Stock Exchange about the ownership of its securities. The Australian Stock Exchange will then release that information to the market. The usual undertakings are to tell the market immediately the entity becomes aware of any person becoming a substantial shareholder and to disclose any details of this substantial shareholding of which the entity is aware.[26] A person has a substantial shareholding in a body corporate if, and only if, the person is entitled to not less than the prescribed percentage of:

- Where the voting shares in the body are not divided into two or more classes, those voting shares; or
- Where the voting shares in the body are divided into two or more classes, the shares in one of those classes.

Section 709 requires a person who is a substantial shareholder in a company to give the company notice in the prescribed form of:

- The person's name and address;
- Particulars relating to his or her relevant interest; and
- Particulars of any agreement or any other circumstances by reason of which he or she acquired the interest.

A person required to give a notice must do so within two business days after becoming aware of the circumstances by virtue of which he is a substantial shareholder. Furthermore,

26 'Substantial Shareholder' is defined to include 'a person who has a substantial shareholding in a body corporate'.

section 709(5) requires notice to be given even if the person has ceased to be a substantial shareholder before the expiry of the two-day period.

A person who fails to comply with the substantial shareholder notice obligations is not guilty of a criminal offence but is liable for damages to any person who suffers loss or damage as a result of that failure. It is a defence if the failure is due to inadvertence, mistake, or to the person not being aware of a relevant fact or occurrence. Finally, where a contravention occurs the courts may make certain orders on the application of the Australian Securities Commission or the company. These include:

- Restraining the acquisition or disposal of an interest in the shares;
- Restraining the exercise of any voting or other rights attached to the shares;
- Directing a company not to pay dividends on the shares;
- Vesting the shares in the Australian Securities Commission;
- Directing the company not to register the transfer of specified shares;
- Cancelling a contract, arrangement, or offer relating to specified shares; and/or
- Directing the company or any other person to do or refrain from doing a specified act for the purposes of securing compliance with any order.

Company Duties. Once a substantial shareholder has notified the company or its holding, the company is to provide such notices to the Australian Stock Exchange. In addition, the Listing Rules expressly require companies to notify the Australian Securities Commission of statements received under the substantial shareholder provisions in the Corporations Law. Annual reports also must contain, *inter alia*, the names of substantial shareholders and the equity securities in which they are interested.

Insider Trading and Fraud

Basis of Territorial Link. 'Insider trading' may be characterised as trading by a trader who possesses information that is 'material' to the price of the securities which are traded, which is not already known to other traders in the market, and which is not the product of analysis of publicly available information by that trader. A trader may obtain access to information of that nature as a result of:

- A relationship with the issuer of the securities;
- A relationship with a prospective bidder for those securities;
- A professional relationship with the issuer or the bidder of the securities; or
- Receiving the information from a person who has such a relationship.

Section 1002G of the Corporations Law contains the primary prohibition against insider trading where:

- A person (the insider) possesses information that is not generally available but, if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of the securities; and

- The person knows or ought reasonably to know that the information was not generally available and, if it were generally available, it might have a material effect on the price or the value of those securities.

Section 1002G of the Corporations Law does not require that there exist any connection or relationship between that person who is prohibited from trading and the body corporate which is the issuer of the securities. A person becomes an insider for the purposes of section 1002G simply by the possession of information having the relevant quality, if that person knows or ought reasonably to know that the information is not generally available and that, if it were generally available, might have a material effect on the price of the securities.

Section 1002G of the Corporations Law states that an insider is prohibited from subscribing for, purchasing, or selling securities, or entering into an agreement to do so, or procuring another person to subscribe for, purchase or sell securities or enter into an agreement to do so. Section 1002G(2) applies to trading in securities of all companies, whether listed or not. Section 1002G(3) prohibits a person from:

- Directly or indirectly communicating material non-public information within the scope of section 1002G to another person; or
- Causing that information to be communicated to the other person if trading on securities is permitted on the stock market of the securities exchange.

Extraterritorial Application. Section 1002G applies to acts and omissions within an Australian state or territory in relation to securities of a body corporate, whether or not the body corporate is formed in or carries on business in Australia. However, however, applies to acts and omissions outside Australia in relation to securities of a body corporate which is formed or carries on business in an Australian state or territory.[27] The prohibition on insider trading, therefore, applies to trading securities of an Australian corporation, even where the trading takes place outside Australia.

Public Take-Over Bids

Listing Rules. As stated earlier, the provisions of the Corporations Law dealing with notification of substantial shareholdings and take-overs do not apply *per se* to companies established outside of Australia. The Listing Rules, however, place obligations on these forms of companies that are listed on the Australian Stock Exchange.

A listed company is required by Listing Rule 3.1 to immediately notify the Australian Stock Exchange of any information which a reasonable person would expect to have a material effect on the price or value of its shares. Listing Rule 3.1.3 requires a listed company to immediately inform the Australian Stock Exchange when it gives or receives a notice of intention to make a take-over offer.

27 Corporations Law (Cth), s 1002(b).

Under Listing Rule 7.1, private placements of more than 10 per cent in nominal value of a company's issued shares (or securities with rights of conversion into ordinary shares) may not be made without prior ordinary shareholder approval, unless the shares are issued, *inter alia*:

- *Pro rata* to all ordinary shareholders;
- As a result of the conversion of convertible securities;
- Pursuant to a take-over offer made by the company complying with part 6.3, division 1, of the Corporations Law; or
- To persons participating in a shareholders' dividend plan or an employee incentive scheme as approved by ordinary shareholders.

In relation to take-overs, once a company has received written notice of an intention to bid for it, under Listing Rule 7.9, the company is restrained for a period of three months from issuing shares or other equity securities unless, *inter alia*:

- The proposed issue was notified to the Australian Stock Exchange before the company was informed of the bid;
- The issue is made *pro rata* to all ordinary shareholders;
- An issue is made on the exercise of rights of conversion; and
- An issue is made under a dividend or distribution that is in operation at the time the notice is received.

Listing Rule 10.1 imposes significant restraints on a company's ability to take action in respect of the purchase or disposition of significant assets or the subscription or allotment of shares from or to particular persons. The listing rule comes into effect where the assets and/or shares exceed five per cent of the total shareholders' funds of the company as at its last balance sheet date, without the prior approval of shareholders in general meeting if the vendor or disponer of the assets or securities is:

- A director or officer of the company or any entity with which it is associated;
- A substantial shareholder of the company who is entitled to at least 10 per cent of its voting securities;
- An associate of the company or its related corporations; or
- Any other person whose association with any such person or company is such that in the opinion of the exchange the proposed acquisition or disposal should be referred to shareholders in general meeting.

The notice of meeting of shareholders to approve any such acquisition or disposal must include a report sufficient to establish that the transaction is fair and reasonable to all other shareholders, other than those who cannot vote. This category includes the purchaser or vendor, any associate, and any other person whose vote the Australian Stock Exchange believes should be disregarded.

Corporations Law. Company take-overs in Australia are primarily regulated by chapter 6 of the Corporations Law.

Control of the Acquisition of Shares. The Corporations Law prohibits a person, including any form of foreign corporation, from acquiring shares in a company established in Australia if:

- Any person who is entitled to less than 20 per cent of the voting shares in the company, immediately after the acquisition, would be entitled to more than 20 per cent; or
- Any person who is entitled to between 20 per cent and 90 per cent of the voting shares in the company would, immediately after the acquisition, be entitled to a greater percentage, unless the acquisition is in accordance with one of the specific exceptions set out in the Corporations Law.

An acquisition is generally constituted by the purchase of existing shares or the issue of new shares. A voting share is an issued share that confers a right to vote not being a right to vote that is exercisable only in one or more of a number of limited circumstances. These limited circumstances are typically associated with the limited voting rights of preference shares.

The prohibition relates to the acquisition of any class of shares, even though the 20 per cent threshold relates to voting shares. Thus, an acquisition of non-voting shares could contravene the law if it increases the percentage entitlement to voting shares beyond the 20 per cent threshold. In addition, there is no restriction on an acquirer's percentage entitlement to non-voting shares or to other securities such as options over unissued shares or convertible notes. However, the Corporations Law restricts the circumstances in which those securities may be converted into voting shares.

An acquirer can contravene the law by an acquisition which leads to another person increasing its entitlement beyond the 20 per cent threshold. As alluded to and defined earlier in this chapter, the concept of entitlement is central to the prohibition and is defined in the Corporations Law. A person is entitled to shares in most cases if that person or an associate of that person has a relevant interest in the shares.

The Corporations Law relating to take-overs purports to have extraterritorial operation and Australian law may have force even though a transaction might comply with the laws of other countries. For example, the take-over of a United States company which holds more than 20 per cent of the voting shares in an Australian listed company would attract the provisions of chapter 6 of the Corporations Law. However, the Australian Securities Commission does have discretionary powers to exempt such acquisitions from the impact of the Corporations Law in certain circumstances.[28]

Objectives of Take-Over Provisions. Part 6.9 of chapter 6 of the Corporations Law deals with the powers of the Australian Securities Commission, the Corporations and Securities Panel, and the courts relating to unacceptable circumstances in acquisition and take-over situations. Section 731 of the Corporations Law sets out the objectives underlying the regulation of acquisitions and take-overs as embodied in chapter 6 of the Corporations Law. These objectives are:

- Shareholders and directors know the identity of any person who proposes to acquire a substantial interest in the company;

28 Corporations Law (Cth), s 728.

- Shareholders and directors have reasonable time to consider any proposals and make a decision;
- Shareholders and directors are supplied with sufficient information; and
- Shareholders have equal opportunity to participate in any benefits of the offer.

Section 732 provides that unacceptable circumstances have occurred if those objectives have not been present in an acquisition of shares or in relation to the conduct of a person. Where the Australian Securities Commission believes that one or more of these objectives may have been infringed, it may apply to the Panel for a declaration in relation to the acquisition or conduct of a person. The Panel simulates the Take-Overs Panel in the United Kingdom with the function to provide timely and expert decisions on issues arising in a take-over without the need to resort to the courts to avoid delays, technicalities and complications that legal actions can involve.

Although the powers of the Panel are extensive it has never functioned effectively as a result of questions raised about its legality which arose from the Panel's first matter. The Panel has been under review since 1992. In any event, the Australian Securities Commission has the right to institute legal actions should it determine that unacceptable circumstances have occurred.

Take-Over Techniques. Section 615 of the Corporations Law prohibits a person from acquiring voting shares in a company which would result in that person being entitled to more than 20 per cent of the voting shares in that company or increasing their existing holding if such holding is already between 20 per cent to 90 per cent of the company.

This prohibition does not apply to the acquisition of shares made under a take-over scheme[29] or a take-over announcement.[30] There also are other exceptions to this section 615 which will be discussed later in this chapter, such as a three per cent creeping take-over,[31] an acquisition approved by resolution of shareholders of the target company,[32] an acquisition under a scheme of arrangement approved by the court,[33] or an acquisition approved by the Australian Securities Commission.[34]

In situations where foreign companies intend to take over companies listed on the Australian Stock Exchange, the most practical and viable avenue for acquisition is a formal take-over scheme. In essence, this is because on-market take-over announcements must be unconditional, creeping take-overs are too slow, and Australian Securities Commission approval is not readily granted.

Foreign companies also must make thorough investigations into the effect of the Foreign Acquisitions and Take-Overs Act 1975 (Cth). The acquisition of an Australian

29 Corporations Law (Cth), s 616.
30 Corporations Law (Cth), s 617.
31 Corporations Law (Cth), s 618.
32 Corporations Law (Cth), s 623.
33 Corporations Law (Cth), s 625.
34 Corporations Law (Cth), s 633.

company via a company controlled by persons who are not Australian residents would usually require the approval of the Federal Treasurer pursuant to this Act. In practice, it is usual for the take-over scheme to be made subject to receiving the Treasurer's approval, and an application for approval is immediately lodged after the announcement of the bid. The mechanics of the Foreign Acquisitions and Take-Overs Act 1975 (Cth) will be discussed below.

A take-over scheme is the most common method of acquisition chosen by an acquirer who wishes to hold more than 20 per cent of the voting shares in a listed company. The process will usually take a minimum of three months from announcement to completion, or substantially longer if the offer is contested or runs into regulatory hurdles.

An acquirer must proceed to make its offers within two months after announcing that it proposes to make the take-over offer. Limited exceptions to this rule allow an acquirer not to proceed in certain circumstances, but the exceptions are relied on at some risk (eg, compensating disgruntled shareholders).

The Corporations Law requires an offeror to make an offer to each shareholder holding shares in the class of shares being acquired. The offers must be for all of the shares in that class held by the shareholder or for a fixed proportion of each shareholder's shares.

The take-over scheme (offer) process begins with the preparation of an offer document and 'part A statement'. The offer document will detail the terms of the offer, including the length of the offer period, the consideration and the conditions, if any, to which the offer is subject. It will be accompanied by an acceptance form. The part A statement is a statutory disclosure document. The target company will then respond with a 'part B statement' which contains a recommendation in relation to the offer.

A take-over offer must remain open for at least one month and for not longer than six months from the date of the offer. It is possible to extend the offer period for a further six-month period.

The consideration offered to the shareholders of the target company may be cash, securities (which do not need to be listed securities) or a combination of both. The offer price, in the case of a cash offer, must not be less than the highest price per share paid by the offeror (or its associates) for any shares in the target company in the four months prior to the offer being made. The consideration offered to each shareholder must be the same. The offeror must pay the consideration to shareholders within 30 days after the offer is accepted or becomes unconditional, whichever is the later but, in any event, no later than 21 days after the end of the offer period.

A take-over offer may include conditions or it may be unconditional. A common condition is that the offeror receives acceptances in respect of a minimum percentage of shares. A minimum acceptance condition of 50.1 per cent of the voting shares will ensure outright control of the target company and, generally speaking, a minimum acceptance condition of 90 per cent of the voting shares will usually allow compulsory acquisition of minority shareholdings. A minimum acceptance condition cannot be varied, but it can be waived. Maximum acceptance conditions are not allowed.

Other conditions can be included, such as a condition that foreign investment approval be obtained is obviously very common in situations where foreign companies make take-over offers. Another common condition is that there not be any materially adverse change in the financial position of the target company. Such conditions must not offend provisions of the Corporations Law which prohibit conditions the fulfilment of which depends on an opinion, belief, or state of mind of the offeror or the occurrence of an event which is within the sole control of the offeror or its associates.

Contracts resulting from acceptances of offers will be void if, at the end of the offer period, any condition is not fulfilled. A take-over offer may be declared free from a condition if the declaration is made not less than seven days before the last day of the offer period.

A take-over offer cannot be withdrawn without the written consent of the Australian Securities Commission and that consent will not be readily forthcoming. It is possible for an offeror to vary a take-over offer by improving its terms (eg, increasing the offer consideration or adding a cash alternative to a share consideration) or extending the offer period. Other variations can be made with Australian Securities Commission consent. Any increase in consideration during the offer period must be paid to each person whose shares were acquired before the variation was made.

The Corporations Law requires the offeror to prepare and send a part A statement to shareholders. The part A statement is a document containing information material to a shareholder's decision whether or not to accept the offer. The document must comply with certain requirements set out in the Corporations Law, but it also may contain any information the offeror wishes to include so long as it is not false or misleading. The part A statement and offer must be registered by the Australian Securities Commission and then served on the target company. The part A statement also must be lodged with the Australian Stock Exchange. The part A statement and offer are then sent to target company shareholders at least two weeks (but not more than four weeks) after the part A statement has been served on the target company. The main disclosures in the part A statement will be:

- The offer period;
- Particulars of the offeror and its directors;
- The offeror's entitlement to shares in the target company;
- Particulars of share trading in the target company and in the offeror by the offeror and its associates in the previous four months;
- Particulars of the consideration being offered, including the source of any cash funding;
- Particulars of the offeror's intentions regarding the ongoing business of the target company and the target company's employees;
- Any material changes in the financial position of the target company since the date of its last balance sheet;
- Any other information material to a shareholder in making a decision whether or not to accept the offer; and
- In the case of an offer of securities, additional information of the type that would be included in a prospectus.

After the target company receives the offeror's part A statement, it will respond with a part B statement which must be sent to the offeror and to target company shareholders. If the part B statement is issued within 14 days of receipt of the part A statement, then it will be the offeror's responsibility to send copies to shareholders; otherwise, it will be the target company's responsibility. A copy of the part B statement must be lodged with the Australian Securities Commission and the Australian Stock Exchange. Where an offeror is entitled to more than 30 per cent of the voting shares in the target company or the offeror and the target company have a common director, the part B statement must be accompanied by an expert's opinion as to whether or not the offer is fair and reasonable.

The take-over announcement process begins with the offeror making an announcement to the Australian Stock Exchange of its intention to acquire target company shares at a specified price. The announcement binds the offeror to buy all shares offered at that specified price for a period of one month commencing two weeks after the announcement. The offeror also has the right to commence buying shares before the expiration of that two week period. A take-over announcement cannot be made if the offeror is entitled to 30 per cent or more of the shares in the target company at the time of the announcement.

In a take-over announcement, the offeror must issue a 'part C statement', and the target company must respond with a 'part D statement'. The information contained in those documents is similar to that contained in the part A and part B statements in respect of a take-over offer. A part C offer must be unconditional, and the offer price per share must be in cash and not be less than the highest price per share paid by the offeror (or its associates) in the four months prior to the take-over announcement. The offer price can be increased during the offer period.[35] The main disclosures in the part B statement will be:

- The recommendation of directors whether or not to accept the offer and the reasons for the recommendation;
- The directors' entitlements to shares in the target company;
- Whether the directors intend to accept the offer for their shares;
- The name of any director of the target company who voted against the resolution authorising the part B statement;
- Particulars of share trading in the offeror by the target company and its associates or in the target company by its associates in the previous four months;
- Material changes in the financial position of the target company since the date of its last balance sheet; and
- Any other information material to a shareholder in making a decision whether to accept the offer.

The offeror may acquire the shares held by remaining shareholders by compulsory acquisition where, under either a take-over scheme or a take-over announcement:

35 One of the main advantages of the part C offer over a part A offer is that any increased consideration does not need to be paid to former shareholders of the target company who have already accepted the offer.

- An offeror becomes entitled to not less than 90 per cent of all of the shares in the target company during the course of the offer; and
- If the offeror commenced the offer with an entitlement to more than 10 per cent of the target company's shares; either
- Seventy-five per cent of the offerees have disposed of their shares to the offeror; or
- Seventy-five per cent of the shareholders registered at the commencement of the offer are no longer registered one month after the end of the offer period.

Any person who has not accepted the offer may apply to the court for an order that their shares not be subject to compulsory acquisition, but such applications are rarely successful. If an offeror reaches the 90 per cent threshold and chooses not to proceed to compulsory acquisition, the remaining shareholders are entitled to require that the offeror acquires their shares. Similar rights are given to the holders of non-voting shares, renounceable options and convertible notes in the target company.

An offeror is not allowed to give, offer to give, or agree to give to a target company shareholder a benefit which is not provided for under the take-over offer or take-over announcement. The period during which this prohibition applies commences four months before a proposed take-over offer or take-over announcement, and it runs until the end of the offer period. Thus, an offeror cannot do a 'sweetheart' deal with a major shareholder to ensure its acceptance of the offer.

An offeror who has made a take-over offer or a take-over announcement may not dispose of any shares in the target company until the offer period has expired unless some other person not associated with the offeror makes a take-over offer or take-over announcement.

During a take-over offer or take-over announcement, the offeror must notify the Australian Stock Exchange of all changes in its entitlements to voting shares in the target company by 9.30 a.m. on the next day after shares are acquired.

An acquirer who becomes entitled to five per cent or more of the voting shares in a company (whether or not there is a take-over offer or take-over announcement in progress) must notify the company and the Australian Stock Exchange within two business days. Changes to that entitlement in excess of one per cent of the company's voting shares also must be notified, as must the fact that the acquirer has ceased to be entitled to five per cent of the shares.

Acquirers of shares cannot be guaranteed that their identity will remain anonymous, even if their shareholding is registered in the name of a nominee and is less than five per cent of the company's share capital. The Corporations Law allows the Australian Securities Commission or a listed company (whether or not there is a take-over offer or take-over announcement in progress) to serve a notice on a shareholder requiring information as to the beneficial ownership of the shares. Subsequent notices may be issued to persons who are identified by the shareholder as beneficial owners. Through this process it is possible to discover who is the ultimate controller of a parcel of shares.

Notwithstanding the fact that an acquisition of shares may be made in accordance with the strict requirements of the Corporations Law, the Australian Securities Commission has

power to refer certain conduct in relation to shares to a body called the Corporations and Securities Panel. The Panel is given the power to declare that a particular acquisition is an unacceptable acquisition or that particular conduct in relation to shares is unacceptable conduct. In making a decision, the Panel must take into account the desirability of ensuring that the acquisition of shares takes place in an efficient, competitive, and informed market. The Panel is concerned to see that:

- Shareholders and directors know the identity of the acquirer of a substantial interest;
- Shareholders and directors have a reasonable time to consider a proposed acquisition of a substantial interest;
- Shareholders and directors are supplied with enough information to assess the merits of the proposed acquisition; and
- Shareholders have reasonable and equal opportunities to participate in any benefits accruing to any shareholder in connection with the acquisition.

The Panel must be satisfied that it is in the public interest to make such a declaration. The Panel also can rule on unacceptable conduct of a target company board of directors. The activities of the Panel are designed to ensure that companies comply with the spirit of the law, not just the letter of the law.

The Corporations Law contains extensive provisions relating to liability for false and misleading statements and misleading and deceptive conduct. There are provisions of general liability in addition to provisions which specifically relate to take-overs. The provisions generally apply to all of the parties involved in the take-over process. People who contravene these provisions may be subject to criminal, as well as civil liability.

An offeror may not obtain a formal or informal undertaking from a shareholder that the shareholder will accept an offer if the shares held by that shareholder, together with the shares held by the offeror, exceed the 20 per cent threshold. Any such understanding by the shareholder will amount to an acquisition by the offeror which can only occur legally by way of a take-over offer, take-over announcement, or one of the other permitted exceptions.

In a similar vein, an offeror cannot acquire a major shareholder's shareholding if it would breach the 20 per cent threshold and then follow up that acquisition with a general offer for all of the shares in the target company, even if the later offer is made at the same price as that paid to the major shareholder. Again, the original acquisition can only be made by way of a take-over offer, take-over announcement, or one of the other permitted exceptions. This is a major distinction to the law applying in some foreign jurisdictions.

The creeping take-over[36] allows an acquirer who is entitled to 19 per cent or more of the target company's voting shares to increase that entitlement by three per cent of the total number of voting shares every six months. The person must have been entitled to at least 19 per cent for a continuous period of six months for this exception to apply. This method enables the shareholdings to be increased but has little commercial appeal in terms of obtaining

36 Corporations Law (Cth), s 618.

control of the target company due to the long period required to establish a significant shareholding and because the market will become aware of the creeping acquisitions and the market price of the target company's shares will usually rise in expectation of a take-over.

Under section 623 of the Corporations Law, an acquirer may increase its shareholding in a target company beyond the 20 per cent threshold by purchasing shares or taking an allotment of shares if the target company has agreed to the purchase or allotment by ordinary resolution of its shareholders. The acquirer and the seller and their associates may not vote on such a resolution. Shareholders should be given a full and proper disclosure of all the relevant facts and surrounding circumstances (including an independent expert's report on whether the proposal is fair and reasonable to the non-involved shareholders) so as to be able to make an informed decision.

Section 625 of the Corporations Law provides that the section 615 prohibition does not apply to the acquisition of shares under a scheme of arrangement. Section 411 of the Corporations Law allows for a scheme of arrangement that could result in the cancellation of some of the members' shares to be approved by the shareholders of a company. However, this can be more difficult to achieve than a reduction in capital for the following reasons:

- The special resolution must be approved by at least 50 per cent of those present representing 75 per cent of the value of the shares held by persons voting at the meeting;[37] and
- The scheme of arrangement will not be approved by the court (which must be approached at the beginning and end of the process) unless it is satisfied that the scheme was not proposed for the purpose of enabling any person to avoid the operation of the take-over provisions of the Corporations Law.[38]

Section 619 of the Corporations Law excludes from the operation of the section 615 prohibition the acquisition of shares in a company that has 15 members or less. This exception does not exempt an acquisition if the acquisition also has the effect of increasing the entitlement of the acquiring person in another company beyond the level permitted by section 615. The exemption in section 619 also applies to a proprietary company having more than 15 members where all of the members consent in writing to the provisions of chapter 6 of the Corporations Law not applying.

The exemption as specified in section 633(c) of the Corporations Law is used very sparingly. The Australian Securities Commission's policy appears to be that it prefers to grant written approval under sections 728–730 of the Corporations Law with attaching conditions to such approval rather than using its power under section 633(c).

Antitrust Law

Trade Practices Act 1974. Australia's Trade Practices Act 1974 prohibits any corporation from acquiring shares or assets of another corporation where the acquisition would have the effect, or be likely to have the effect of substantially lessening competition in an

37 Corporations Law (Cth), s 411(4).
38 Corporations Law (Cth), s 411(17).

Australian market. There is a non-exhaustive list of 'merger factors' that may be taken into account to determine whether an acquisition would result in a substantial lessening of competition in a market, namely:

- Actual and potential level of import competition in the market;
- Size of barriers to entry;
- Level of concentration in the market;
- Likelihood that the acquisition would result in the acquirer being able to significantly and substantially increase prices and profit margins;
- Extent to which substitutes are available or are likely to be available in the market;
- Degree of countervailing power in the market;
- Dynamic characteristics of the market, including growth, innovation, and product differentiation;
- Likelihood that the acquisition would remove from the market a vigorous and effective competitor; and
- Nature and extent of vertical integration in the market.

As a preliminary guide, if the merger results in the four largest firms having a market share of 75 per cent or more and the merged firm having a market share over 15 per cent or if the four largest firms have less than 75 per cent, and the merger would result in the merged firm having 40 per cent or more, the Australian Competition and Consumer Commission will desire to examine the potential competition effects of the merger by way of market investigations before deciding whether or not the merger is likely to result in a substantial lessening of competition. If the Commission concludes that the market is not a substantial one or that the acquisition will not substantially lessen competition, it will not oppose the acquisition.

At present, there is no pre-notification requirement for mergers and acquisitions in Australia. However, an acquirer may apply to the Australian Competition and Consumer Commission for authorisation in relation to its acquisition where there are negative anti-trust implications. An application will generally be determined within 30 days. The Commission will only authorise the acquisition when it is satisfied that the acquisition has resulted or would result in a benefit to the public and that benefit outweighs or would outweigh the detriment constituted by any lessening of competition that has resulted or would result from the acquisition. The Commission is to regard the following as benefits to the public when it determines what amounts to a benefit to the public:

- A significant increase in the real value of exports;
- A significant substitution of domestic products for imported goods; and
- All other relevant matters that relate to the international competitiveness of any Australian industry.

Substantial Lessening of Competition. Section 50 of the Trade Practices Act prohibits the acquisition of shares (or assets) if the acquisition would have the effect or be likely to have the effect of substantially lessening competition in a substantial market for goods

or services. The acquisition may be authorised if it results in such a benefit to the public that it ought to be allowed to proceed. Section 50(3) lists the factors to be taken into account in determining whether an acquisition is likely to substantially lessen competition. These are:

- Actual and potential level of import competition in the market;
- Height of barriers to entry in the market;
- Level of concentration in the market;
- Degree of countervailing power in the market;
- Likelihood that the acquisition would result in the acquirer being able to significantly and substantially increase prices or profit margins;
- Extent to which substitutes are available in the market or are likely to be available in the market;
- Dynamic characteristics of the market, including growth, innovation, and product differentiation;
- Likelihood that the merger would result in the removal from the market of a vigorous and effective competitor; and
- Nature and extent of vertical integration in the market.

Foreign Investment Approval

Foreign Acquisitions and Take-Overs Act 1975 (Cth). Foreign investment in Australia is generally subject to the approval of the Federal Treasurer pursuant to the Foreign Acquisitions and Take-Overs Act 1975 (Cth). The Act usually requires compulsory notification of proposed acquisitions of shares in Australian listed companies and gives the Treasurer the power to prohibit, impose conditions on, or order divestiture in relation to certain proposed or completed acquisitions. The Federal Treasurer is advised on these matters by the Foreign Investment Review Board.

The Act makes it an offence for a foreign person proposing to acquire a 15 per cent shareholding, or two or more foreign persons proposing to acquire a 40 per cent shareholding, in an Australian company which has assets valued at Aus $5 million or more, to proceed without the consent of the Treasurer. These thresholds include shares held by associates (very broadly defined) of the acquirer. However, a take-over offer (but not a take-over announcement) could proceed if it were made conditional on receiving the Treasurer's consent. The Treasurer's consent will be forthcoming unless the acquisition is deemed to be contrary to the national interest. Consent can usually be obtained within 30 days. Some off-shore acquisitions also could be caught by the Act if Australian assets are involved.

Major Requirements of the Act. Essentially, sections 4-9A of the Act define a foreign interest as:

- A natural person not ordinarily resident in Australia; or
- Any corporation, business, or trust in which there is a substantial foreign interest.

'A substantial foreign interest' in a corporation, business, or trust occurs where there is a single holding of 15 per cent or more by a single foreign interest or an aggregate holding of 40 per cent or more by multiple foreign interests. There also are provisions designed to catch holdings engineered through associates. The Act provides the Federal Treasurer with power to examine four categories of foreign investment proposals. These are:

- Shareholdings in Australian corporations — Section 26 requires a foreign interest to notify the Foreign Investment Review Board (FIRB) of any proposal to acquire a shareholding of 15 per cent or more of an Australian corporation. Section 13A provides an exemption if total assets of the corporation being acquired are Aus $5 million or less (Aus $3 million or less if more than 50 per cent of this value is represented by rural land).
- Take-overs of Australian companies other than by acquisitions of shares — These provisions impose the same restrictions on acquisitions of assets or interests in assets, agreements in relation to control of companies or assets, and arrangements for participating in the profits of a business.

Take-Overs of Offshore Companies. Approval is required for the acquisition of an offshore company if the company has an Australian subsidiary with more than Aus $20 million of assets or if the Australian assets constitute more than 50 per cent of its total assets.

Urban Land. Section 26A compels a foreign interest to notify the Foreign Investment Review Board of a proposal to acquire an interest in urban land. Significant exemptions to section 26A, such as for an Australian citizen not currently resident in the country, are granted in the regulations to the Act. There are wide-ranging anti-avoidance provisions in section 38A.

Foreign Investment Policy. The current federal government, with its push towards a less regulated marketplace, has pursued a different philosophy as to what benefits the national interest. This change of philosophy has substantially increased the chances of a foreign investor obtaining a Foreign Investment Review Board clearance in many circumstances. However, as will be seen below, the Act's machinery remains in place, and there are a number of industries that are restricted for foreign investors.

The Treasurer has announced that, in particular sectors such as manufacturing, oil and gas, insurance, stockbroking, tourism, rural properties, agriculture, forestry, fishing, resource processing, non-bank financial intermediaries, mining (excluding uranium), and services (excluding urban real estate, banking, civil aviation, and the media), the government will normally automatically approve proposals to acquire 15 per cent or more of a company which has assets of less than Aus $50 million and where the consideration payable is also less than Aus $50 million. Special policies apply to the sectors of banking, civil aviation, media, insurance, mining (some uranium projects), and urban real estate. Industry specific legislation also may need to be considered in certain of these sectors.

Recognition of Foreign Take-Over Regulations

The provisions of chapter 6 of the Corporations Law do not apply to acquisitions of shares in foreign companies incorporated outside of Australia. Where a foreign company is listed on the Australian Stock Exchange and that foreign company is the subject of a take-over, the general view in Australia (as held by the Australian Stock Exchange) is that the law of the place of incorporation or the rules of its home exchange (where the foreign company holds a primary listing) apply and regulate the take-over bid made for that foreign company.

It should be noted that the provisions of chapter 6 of the Corporations Law may apply to an acquisition of shares in a foreign company where the acquisition increases the acquirer's entitlement to voting shares in an Australian company beyond the limits set in section 615 of the Corporations Law. The take-over provisions set out in chapter 6 of the Corporations Law do apply to foreign companies dealing in shares of Australian companies. However, there are difficulties in enforcing any determinations or court orders against a foreign company.

Jurisdictional Conflicts

Genuine and False Conflicts

Although, *prima facie*, there are currently genuine conflicts relating to the regulation of securities around the world, the key feature that underlies the concept of globalisation of financial markets is the erosion and irrelevance of national boundaries and the emergence of services and markets that can be truly described as global. The main areas of change in the international financial markets have been in the international financial system, advances in and the fusion of information technology in telecommunications, the rise of global business strategies, new political and economic structures, new political imperatives such as economic liquidisation, privatisation, and deregulation, and the rise of the institutional investor. The key drivers of change in the international financial markets have been technology and micro-economics.

Indeed, financial markets are now completely integrated and linked via technology, on a viable basis. The main implication is that regulators no longer have sovereignty over the movements of capital across the national boundaries. As money is fungible and will gravitate to those centres where the most attractive environment is maintained, the case of multinationals may cause problems. As the nationality of such corporations may be very hard to ascertain, questions relating to regulatory sovereignty may tend to arise in the future. This problem is magnified by the trend towards mergers and alliances between corporations from different geographical centres.

It is for this reason that many commentators now believe that those countries with an open-market approach to regulation (as distinct from attempts to preserve national boundaries) are more likely to prosper in the global economy as capital increasingly ignores national boundaries.

Multilateral Approaches

Harmonisation

Government polices affect the operating environment of financial services in two principal areas, ie, tax and regulation. Various taxes limit Australia's international competitiveness. These include:

- Capital gains tax with no threshold, imposing marginal rates of taxation with losses quarantined;
- A dividend imputation system that does not apply to foreign companies that pose Australian tax and have Australian shareholders;
- Interest withholding tax and fringe benefits tax anomalies in respect of foreign operations;
- State taxes on bank deposits and withdrawals; and
- A level of state stamp duty on share transactions that remains one of the highest in the world.

An example of where inefficiencies have been recognised and corrected can be seen in the Queensland government's initiative in halving the rate of stamp duty on share transactions in mid 1995. Detailed studies demonstrate that this reduction in duty resulted in the net economic benefit for Australia of Aus $4.6 billion on a present-value basis. Furthermore, increased market activity post the stamp duty reduction will result in state governments budgeting to collect almost as much revenue in any event. In addition, in March 1997, the Financial System Inquiry reported a number of recommendations. The recommendations include that:

- A single regulator called the Australian Securities and Investments Commission should combine the existing market integrity, corporations, and consumer protection roles of the Australian Securities Commission, the Insurance and Superannuation Commission, and the Australian Payments Council;
- There be a generic regulation of financial products instead of the artificial distinction between securities and futures contained in the present Corporations Law, therefore encouraging the creation of innovative financial products, particularly those that are not easily defined as either 'securities' or 'futures';
- A Financial Sector Advisory Council be established to advise the Treasurer on regulation (including its cost effectiveness and relevance, financial sector developments, and the international competitiveness of Australia's financial sector);
- Capital gains tax be reviewed as it presently significantly depresses risk-taking investment and reduces the pool of capital available for investment in venture capital and growth orientation but non-dividend paying enterprises; and
- The dividend imputation system be changed so that it applies to Australian taxpayers investing in foreign companies that pay company tax in Australia.[39]

39 Their exclusion at present is not only discriminatory but discourages foreign companies with Australian operations from listing on the Australian Stock Exchange.

The Australian Stock Exchange is responding to globalisation in the following ways:

- Through its demutualisation;[40]
- Providing new services for which there is demand;
- Developing the Australian market as an international centre for trading resource stocks;
- Developing a new primary market on which small and medium sized enterprises can raise equity capital at a stage in the development before they are ready to become listed companies;[41]
- Providing a new matching facility after the close of normal trading at 4 p.m., which is designed to reduce the market-impact costs of trading large parcels;
- Examining a proprietary electronic matching market system which will provide price discoveries;
- Creating a new trading platform will be created for the equities market (SEATS 1997);
- Establishing an automated trading system to be created to replace floor trading in the derivatives markets;
- Creating an automated settlement system for all eligible companies (CHESS); and
- Providing for secondary listing of exempt foreign entities for whom many of the Australian Stock Exchange's ongoing Listing Rules do not usually apply.

Recognition

As an example of the harmonisation process, the Australian Stock Exchange has approved a number of foreign exchanges. Basically, they are those exchanges which are members of the International Association of Securities Exchanges. By approving these exchanges, the Australian Stock Exchange recognises that such exchanges are internationally recognised and impose and enforce high listing and quotation standards and market information and regulatory requirements on the listed entities of those exchanges. These include:

- Argentina, Bolsa De Comerico De Buenos Aires (member);
- Australia, Australian Stock Exchange Ltd (member);
- Austria, Vienna Stock Exchange (member);
- Belgium, Bourse De Bruxelles SC (member);
- Brazil, Bolsa De Valores Do Rio De Janeiro (member) and Bolsa De Valores Do São Paulo (associate member);

40 In 1998, after federal parliament passes enabling legislation, the Australian Stock Exchange will become a company limited by shares. The aim of demutualisation is to achieve a more flexible and responsive corporate structure to cope with the competitive pressures of globalisation and emerging competition within Australia.

41 This enterprise market will use Internet technology to create an electronic space within which companies seeking capital and providers of capital can meet before they negotiate on investment, and investments can be bought and sold.

- Canada, Toronto Stock Exchange (member), Bourse De Montreal (associate member), and Vancouver Stock Exchange (associate member);
- Chile, Bolsa De Comercio De Santiago (member);
- Denmark, Kobenhavns Fondsbors (member);
- Finland, Helsinki Stock Exchange (member);
- France, SBF—Paris Bourse (member);
- Germany, Deutsche Borse AG (member);
- Greece, Athens Stock Exchange (member);
- Hong Kong, Stock Exchange of Hong Kong Ltd (member);
- Indonesia, Jakarta Stock Exchange, Inc (member);
- Iran, Tehran Stock Exchange (member);
- Israel, Tel Aviv Stock Exchange Ltd (member);
- Italy, Italian Stock Exchange Council (member);
- Japan, Tokyo Stock Exchange (member) and Osaka Securities Exchange (associate member);
- Korea, Korea Stock Exchange (member);
- Luxembourg, Sociètè De La Bourse De Luxembourg SA (member);
- Malaysia, Kuala Lumpur Stock Exchange (member);
- Mexico, Bolsa Mexicana De Valores (member);
- The Netherlands, Amsterdamse Effectenbeurs (member) and European Options Exchange (associate member);
- New Zealand, New Zealand Stock Exchange (member);
- Norway, Oslo Bors (member);
- The Phillippines, Philippine Stock Exchange Inc (member);
- Poland, Warsaw Stock Exchange (member);
- Republic of China, Taiwan Stock Exchange (member);
- Singapore, Stock Exchange of Singapore Ltd (member);
- South Africa, Johannesburg Stock Exchange (member);
- Spain, Bolsa De Madrid (member), Barcelona Stock Exchange (associate member), and Bolsa De Bilbao (associate member);
- Sweden, Stockholm Stock Exchange (member);
- Switzerland, Swiss Exchange (member);
- Thailand, Stock Exchange of Thailand (member);
- Turkey, Istanbul Stock Exchange (member);
- United Kingdom, London Stock Exchange (member);
- United States, New York Stock Exchange, Inc (member), American Stock Exchange, Inc (associate member), Chicago Board Options Exchange, Inc (associate member), Chicago Stock Exchange, Inc (associate member), and National Association of Securities Dealers, Inc (associate member); and
- Secretariat, Fèdèration International des Bourses de Valeurs, Secretariat General.

Unilateral Approaches

In General

At present, the centrepiece of the Australian approach for the reform of securities regulation is the Corporate Law Economic Reform Program. The objectives of the program are to ensure that business regulation is consistent with promoting a strong and vibrant economy and provides a package which will assist business in adapting to global change. Apart from seeking to improve market freedom and flexibility, the central factor of the Corporations Law Economic Reform Programme agenda is the reform of Australian accounting standards in an effort to harmonise them with international standards. These, and the other matters already mentioned as included on the reform agenda of the Corporate Law and Economic Reform Program are aimed at facilitating freer international involvement in the securities market in Australia.

Another indication of Australia's intention to reform the securities law and to keep pace with global change can be seen in the March 1997 financial system inquiry, also discussed above. The central objective of the inquiry was to make recommendations for the improvement of the efficiency and flexibility of the Australian securities market. These recommendations can be seen as an indication of the desire of the Australian regulators to reform the industry.

Corporate Law Economic Reform Program

Liberalisation of world capital markets, in combination with technological developments and information in telecommunication industries, has fundamentally altered the nature and operation of business in the financial system. In response, the Corporate Law and Economic Reform Program was announced by the Treasury in March 1997. It involves a fundamental review of key areas of regulation which affect business and investment activity. The objective of the program is to ensure that business regulation is consistent with promoting a strong and vibrant economy and provides a package which will assist business in adapting to global change.

In releasing the third paper in a series of six dealing with directors' duties and corporate governance, the Treasurer stated that:

> . . . [i]n striking this balance, close attention has been paid to the international environment in which our companies operate. An international best practice regulatory framework for directors' duties and corporate governance is essential for the Australian economy, which relies on both domestic and foreign capital.

This comment emphasises Australia's push towards taking on and adopting international standards and regulation in this areas. The key principles underlined in the Corporations Law Economic Reform Program review are as follows:

- Market freedom — Regulations needed to help markets whereby enhancing market integrity and capital market efficiency. At the same time the framework needs to be sufficiently flexible so that it does not impede market evolution in competition.

- Investor protection — All investors should have reasonable access to information regarding the risks of a particular investment opportunity.
- Information requirements — Disclosure of relevant information enables rational investment decision-making and facilitates the efficient use of resources by companies. Disclosure requirements increase the confidence of individual investors in the fairness and integrity of financial markets and, by fostering confidence, encourage investment.
- Cost effectiveness — A flexible and transparent regulatory framework will be more conducive to innovation and risk-taking, which are fundamental elements of a thriving market economy, while providing necessary investor and consumer protection.
- Regulatory neutrality and flexibility — The framework should be flexible enough to permit market participants to respond to future changes in an innovative, timely and efficient manner.
- Business ethics and compliance — It is necessary to foster an environment that encourages high standards of business practice and ethics.

Reform Agenda

At present, there are six reform programs. These include reform of:

- Accounting standards, with the goal of ensuring that standards reflect contemporary conditions with emphasis placed on harmonising Australian standards with international standards;
- Fund raising, removing impediments to fund raising and improving capital market efficiency;
- Directors' duties and corporate governance, with emphasis on the protection of sound business judgments and the introduction of a 'business judgment' rule in assessing directors' duties;
- Take-overs, with a goal of providing greater certainty for bidders while providing adequate protection for shareholders;
- Electronic commerce, to modernise the law and facilitate the use of emerging technologies; and
- Futures and securities market, with specific emphasis on the emergence of derivatives in world capital markets.

Austria

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Austria

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Introduction

Special Legislation for Hypo Alpe-Adria-Bank International AG

In 2007, Carinthia sold the Hypo Alpe-Adria-Bank International AG (HAA) to BayernLB and, in December 2009, the Republic of Austria nationalized HAA again due to severe financial problems. The courts are currently deciding whether the circumstances of the purchase by BayernLB and the nationalization are valid.[1]

After a long discussion, the Austrian parliament — with the votes of the governing parties — passed four new acts on a reorganization of HAA on 8 July 2014 (the 'HAA Legislation'). The acts are intended to become effective in August 2014. In addition, the Financial Market Authority Act and the Financial Market Stability Act were amended in order to comply with the above-mentioned drafts. In general, the HAA Legislation, in particular the Act on Restructuring Measures, provides for a basis to ensure the winding down of HAA's assets in an organized, active, most efficient, and quick way, thereby protecting public funds (ie, shifting the burden of saving HAA from the taxpayer to certain creditors). In order to achieve this objective, subordinated obligations (with a guarantee by Carinthia) and liabilities towards shareholders will be terminated.

The HAA legislation has been criticized heavily by rating agencies, market participants, and banking associations. Just recently, the IMF criticized the envisaged actions according to the HAA Legislation. The Austrian government itself expects the HAA Legislation to be attacked by investors. The HAA legislation also has been criticized by legal scholars, identifying that it might raise issues in connection with Constitutional and European law.

Alternative Investment Fund

On 17 December 2013, the Commission of the European Union (EU) adopted a Delegated Regulation supplementing Directive 2011/61/EU with regard to

1 The previous authors were Andreas Sereinig, Philip Rosenauer, Petra Fizimayer, and Catherine McEneney Chan.

regulatory technical standards determining types of alternative investment fund managers.

The Delegated Regulation determines whether an Alternative Investment Fund Manager (AIFM) is an AIFM of open-ended AIF(s) and/or closed-ended AIF(s). Under the Alternative Investment Fund Managers Directive,[2] AIFMs must follow specific rules, depending on whether or not they are AIFMs of open-ended and/or closed-AIFs. Therefore, it is important to foresee detailed rules determining whether an AIFM is managing open-ended and/or closed-ended AIF(s). Austria implemented Directive 2011/61/EU with the Alternative Investment Fund Act (*Alternative Investmentfonds Manager-Gesetz*, AIFMG).

European Law

As a consequence of the European financial crisis, several new Regulations and Directives have been enacted by the EU. They include:

- Alternative Investment Fund Managers Directive (see text, above);
- Market Infrastructure Regulation (EMIR),[3] the new European regulation on over-the-counter (OTC) derivatives. The EMIR establishes a counterparty, requires financial institutions to clear standardized derivative contracts with the counterparty, and report transactions to the counterparty;
- Capital Requirements Regulations (CRR),[4] establishing new standards for capital requirements of financial institutions (Basel III agreement), which was enacted on 1 January 2014;[5]
- Capital Requirements Directive (CRD),[6] providing a legal framework for supervising credit institutions, investment firms, and their parent companies in all EU member states;[7]
- Bank Recovery and Resolution (BRRD),[8] providing authorities with more comprehensive and effective arrangements (eg, a bail-in tool) to deal with

2 Directive 2011/61/EU.

3 Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties, and trade repositories.

4 Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 648/2012.

5 The CRR requires financial institutions to keep sufficient capital reserves and liquidity in order to make EU banks more stable and reinforce their ability to properly manage the risks related to their activities, and absorb any losses they may incur.

6 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

7 The CRD concerns general provisions regarding, *inter alia*, the supervised entities in scope of the CRD and CRR, the tasks and general competences of competent authorities, and market entry for credit institutions.

failing banks at national level, as well as cooperation arrangements to tackle cross-border banking failures;

- European Venture Capital Funds,[9] setting out a new 'European Venture Capital Fund' label (ie, category) and including new measures to allow venture capitalists to market their funds across the EU and grow while using a single set of rules;[10] and
- European Social Entrepreneurship Funds,[11] setting out a new 'European Social Entrepreneurship Fund' label, so that investors can easily identify funds that focus on investing in European social businesses.[12]

As necessary, the Austrian government implemented (or will implement) new legislation by enacting new acts or amending existing acts to incorporate the new EU policies.

Legal Sources

Regulations for securities and investment businesses can be found in a large number of federal laws and several ordinances enacted by the Financial Market Authority (FMA). The most important sources of federal law containing securities regulations referenced in this chapter are:

- The Stock Exchange Act (*Börsegesetz,* BörseG);[13]
- The Banking Act (*Bankwesengesetz,* BWG);[14]
- The Stock Corporations Act (*Aktiengesetz,* AktG);[15]
- The Securities Supervision Act 2007 (*Wertpapieraufsichtsgesetz*, WAG);[16]

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8 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU, and 2013/36/EU, and Regulations (EU) 1093/2010 and (EU) 648/2012, of the European Parliament and of the Council.

9 Regulation (EU) 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds.

10 By introducing a single rulebook, venture capital funds will have the potential to attract more capital commitments and stimulate growth.

11 Regulation (EU) 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds.

12 Every fund using the label must prove that a high percentage of investments (70 per cent of the capital received from investors) are spent on supporting social businesses.

13 Stock Exchange Act, BGBl Number 555/1989 (amended by BGBl I Numbers 70/2013 and 148/2013).

14 *Bankwesengesetz*, BGBl Number 532/1993 (amended by BGBl I Numbers 70/2013 and 148/2013).

15 *Aktiengesetz*, BGBl Number 98/1965 (amended by BGBl I Number 35/2012).

- The Takeover Act (*Übernahmegesetz,* ÜbG);[17]
- The Capital Market Act (*Kapitalmarktgesetz,* KMG);[18]
- The Depositories Act (*Depotgesetz*);[19]
- The Investment Funds Act 2011 (*Investmentfondsgesetz* 2011*,* InvFG);[20]
- The Alternative Investment Fund Act (*Alternative Investmentfonds Manager-Gesetz*, AIFMG);[21]
- The Financial Market Supervision Act (*Finanzmarktaufsichtsbehördengesetz,* FMABG);[22]
- The Issuer Compliance Resolution 2007 (*Emittenten-Compliance-Verordnung* 2007*,* ECV 2007*)*;[23] and
- The Telecommunications Act 2003 (*Telekommunikationsgesetz* 2003*,* TKG 2003*)*.[24]

Austria has implemented numerous EU Directives on securities business and market supervision, including:

- The Capital Adequacy Directive;[25]
- The Money Laundering Directive;[26]
- The Second Directive on the Coordination of Banking Law;[27]
- The Transparency Directive;[28]

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16 *Wertpapieraufsichtsgesetz*, BGBl Number 60/2007 (amended by BGBl I Numbers 70/2013 and 148/2013).

17 *Übernahmerechts Änderungsgesetz*, ÜbeRÄG 2006, BGBI I Number 75/2006.

18 *Kapitalmarktgesetz*, BGBl Number 625/1991 (amended by BGBl I Numbers 70/2013 and 148/2013).

19 *Depotgesetz*, BGBl Number 424/1969 (amended by BGBl I Number 53/2011).

20 Investment Fund Act 2011, BGBl I Number 77/ 2011 (amended by BGBl I Numbers 70/2013 and 148/2013).

21 *Alternative Investmentfonds Manager-Gesetz,* BGBl I Number 135/2013.

22 *Finanzmarktaufsichtsbehördengesetz*, BGBl I Number 97/2001 (amended by BGBl I Numbers 70/2013 and 148/2013).

23 *Emittenten-Compliance-Verordnung* 2007, BGBI II Number 213/2007 (amended by BGBI II Number 30/2012).

24 *Telekommunikationsgesetz* 2003, BGBI I Number 70/2003 (amended by BGBI Number 96/2013).

25 Capital Adequacy Directive, European Community Directive 2006/49/EC (amended by Directive 2008/23/EC).

26 Money Laundering Directive, European Community Directive 2005/60/EC (amended by Directive 2008/20/EC).

27 Second Directive on the Coordination of Banking Law, European Community Directive 89/299/EEC (amended by Council Directive 92/16/EEC).

28 Transparency Directive, European Community Directive 2004/109/EC (amended by Directive 2010/78/EU).

- The Securities Admission Directive;[29]
- The Disclosure Directive;[30]
- The Public Offer Prospectus Directive;[31]
- The Insider Dealing Directive;[32]
- The Market in Financial Instruments Directive;[33]
- The Alternative Investment Funds Directive;[34]

Authorities and Procedure

Stock Exchange

The Austrian Stock Exchange[35] (*Börseunternehmen, Wiener Börse,* leads and manages the regulated market 'Stock Exchange') is empowered to decide on the admission of market participants and securities. These competences are granted by public law. Additionally, the Stock Exchange carries out the market supervision, except for market manipulation and insider trading, which is conducted by the FMA.

The Stock Exchange supervises the trade electronically and is able to gather all necessary information from the market participants.[36] All members of the exchange have wide-ranging disclosure duties to the Stock Exchange. The Stock Exchange Commissioners and their Deputies must be appointed by the Minister of Finance; such appointees must report to the competent supervisory authority. Additionally, the Commissioners and their Deputies must be given due notice of and access to the following meetings:

- General meetings;

29 Securities Admission Directive, European Community Directives 79/279/EEC and 2001/34/EC.

30 Disclosure Directive, European Community Directive 82/121/EEC; Directive 2003/6 EC, implemented through Directives 2003/125/EC and 2003/124/EC; Directives 78/660/EEC and 83/349/EEC, amended by Directive 2009/49/EC.

31 Public Offer Prospectus Directive, European Community Directives 89/298/EEC and 2003/71/EC, amended by Directives 2008/11/EC and 2010/73/EU.

32 Insider Dealing Directive, European Community Directives 89/592/EEC and 2003/6/EC (amended by Directive 2010/78/EU; will be repealed by Directive 2014/57/EU).

33 Market in Financial Instruments Directive, European Community Directive 2004/39/EC (amended by Directive 2008/10/EC); will be repealed by Directive 2014/65/EU.

34 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) 1060/2009 and (EU) 1095/2010.

35 The term ‘stock exchange operating company’ also is used in official translations.

36 Stock Exchange Act, art 25 (Surveillance of Trading), paras 1 and 2.

- Supervisory board meetings;
- Supervisory board's decision-making;
- Managing initial admission meetings;
- Member suspension or expulsion meetings; and
- Negotiable instrument admission or rescinding of admission meeting.[37]

The Commissioners and their Deputies are entitled to speak at any time upon their request. In the event the Exchange Commissioners believe a resolution and/or decision conflicts with federal laws, Commissioners must raise an objection immediately.

Financial Market Authority

On 1 April 2002, the FMA was established through the Financial Market Supervision Act. All supervisory tasks and resources were transferred from the Federal Ministry of Finance to the new supervisory authority. The FMA is now the single, statutory supervisory body directly responsible for banking, insurance and pension funds, securities, and stock exchange supervision.

The FMA is vested with various powers, such as administrative penal power, power to enforce its supervisory rulings, and power to issue ordinances.[38] However, conflicting European Supervisory Authority decisions regarding financial institutions supersede prior decisions issued by the FMA.[39]

Within the FMA, an Executive Board and a Supervisory Board are established.[40] The Executive Board manages all of the FMA's operations and conducts the FMA's business. The Supervisory Board oversees the management and the conduct of business of the FMA.[41]

Takeover Commission

The Takeover Commission[42] decides on the lawfulness of voluntary takeover bids, as well as on the duty to make mandatory bids. Relevant information about the acquisition of controlling holdings must be transmitted to the Takeover Commission.[43]

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37 Stock Exchange Act, art 46, para 2.

38 VwGH 28.02. 2011, 2010/17/0202 (re: deciding on the lawfulness of an ordinance issued by the FMA).

39 Investment Fund Act 2011 (amending the FMA Code (FMABG) through arts 21a and 21b).

40 *Finanzmarktaufsichtsbehördengesetz*, art 4, nos 1 and 2.

41 See http://www.fma.gv.at/en/about-the-fma/organisation/organisation-chart.html.

42 Takeover Act, art 28.

43 Takeover Act, art 22, para 1.

Procedures

The Stock Exchange Act, the Securities Supervision Act 2007, and the Takeover Act state specific procedural rules for the competent authorities. Nevertheless, all the main procedures concerning securities are administrative procedures according to the General Administrative Procedures Act 1991.

Decisions issued by the Stock Exchange and the FMA can be appealed to the Federal Administrative Court (*Bundesverwaltungsgericht*).[44] Decisions issued by the Takeover Commission can be appealed to the Supreme Court (*Oberster Gerichtshof*) and, if imposing penalties, to the Federal Administrative Court (*Bundesverwaltungsgericht*).[45]

Capital Market

Issuer

Issuer Requirements

The Stock Corporations Act does not provide on-point guidance on the corporate action required for the issuance of securities. The management board may submit the listing admission application according to article 71 of the Stock Corporations Act. The supervisory board must at least be informed and, in most cases, its approval is necessary. An increase of share capital requires the consent of the shareholders at the general meeting and must be registered in the Commercial Register.

Stockholders have preemptive rights, meaning that when new shares are issued, each stockholder has the right to purchase the amount of shares necessary to maintain his ownership by percentage. All joint-stock companies with officially quoted shares must guarantee equal treatment of all their shareholders and inform them of their rights, the shareholders' meetings, and the dividend payments by publishing announcements or circulars. Registration of public offerings is not required by Austrian law. Issuers who intend to offer securities to the public must prepare a prospectus. The prospectus must be examined by a credit institution or any other entity specified in article 8 of the Capital Market Act. The examination must comply with the requirements stipulated in the Capital Market Act. The issuer and the examining entity are responsible for the content of the prospectus. The prospectus must be published at least one banking day prior to the offer.

Admission to Listing of Official Market. Before securities and issuing programs may be admitted to listing on the Official Market, the issuer must

44 Stock Exchange Act, art 25, para 7, art 64, para 2; *Finanzmarktaufsichtsbehördengesetz*, art 22, para 2.

45 Takeover Act, arts 30a and 35.

satisfy certain conditions. The issuer's establishment and its bylaws or articles of association must comply with the law of the country in which the issuer's registered office exists. [46]

A stock company with shares admitted for the first time must have existed for a period of at least three years and must have published annual accounts in accordance with applicable regulations for the three complete fiscal years preceding the application. If the joint-stock company is the universal successor to another company and the accounting is continuous, the period of existence of the previous company shall be credited to the successor. The requirement of the three-year period of existence may not apply if it is in the interests of the issuer and of the public, and documents are provided containing information equivalent to the annual accounts of the past three years, regarding the evaluation of the economic and legal status of the issuer. Additionally, the stock company must have published financial reports for at least one full fiscal year.[47] Companies participating in the capital market must publish their consolidated accounts in accordance with the accounting regulations IAS/IFRS.

Finally, the issuer must have abided by the applicable federal acts and laws governing the issuance of securities, along with decrees and official notices resulting from such legislation. This condition applies *mutatis mutandis* to foreign regulations of the country in which the security has been issued. If the securities need to be registered in a public register, this registration must have been completed.[48]

National Treatment

In general, foreign issuers' company shares may be admitted to listing on the Stock Exchange under national conditions. However, if shares of a company with its registered office outside of the European Union are unlisted in the company's home country and in the country where they are primarily traded, admission will only be granted if the company gives a plausible explanation which proves that the shares are not listed on the exchange in these countries for reasons other than investor protection.[49]

Investment Funds

Investment Funds Act 2011. The Investment Funds Act 2011 (InvFG) provides for the implementation of a uniform Key Investor-Information Document (*Kundeninformationsdokument*, KID)[50] to manage the extensive spectrum of

46 Stock Exchange Act, art 66a, para 1, no 1.
47 Stock Exchange Act, art 66a, para 1, no 3.
48 Stock Exchange Act, art 66a, para 1, no 4.
49 Stock Exchange Act, art 71.
50 Investment Fund Act 2011, ordinance of the FMA on the Client-Information Document (KID-V).

tendered Undertakings for Collective Investment in Transferable Securities (OGAW or UCITS; UCITS-shares).[51]

Thus, in addition to supplying investors with a high degree of protection, the InvFG also enables consistent monitoring of management companies of UCITS-shares by extending compliance rules and creating uniform organizational requirements. A management company with its office in another member state is permitted to administer a UCITS in order to generate and increase synergies. Efficiencies are increased within the Inner-European Market by harmonizing deadlines to render decisions, and requires the FMA to approve cross-border and domestic UCITS-mergers.[52] Criteria for approval include the appropriate information, such as plans regarding unit-holders, compliance with regulations, and the updated prospectus.[53]

Master-Feeder Structures. In response to an EU Regulation and the developments on financial markets and the needs of the Funds industry, the InvFG encompasses Master Feeder-Structures.[54] A Feeder-UCITS is permitted to invest up to 85 per cent into a Master-UCITS without requiring the latter to raise funds from the public if at least two Feeder-UCITS are invested in the Master-UCITS.[55]

Corresponding References and Regulations. The terms provided in the InvFG are not completely defined; instead, it refers the reader to the Capital Market Act, the Banking Act, and various EU Directives and Regulations.[56] Hence, management companies or capital investment companies with their registered office in Austria are considered credit institutions that can conduct investment business pursuant to UCITS Directive 2009/65/EC and the Banking Act.[57]

Despite the frequent references to various acts and regulations, ie, the Banking Act, the InvFG is *lex specialis* regarding UCITS. Thus, in order to prevent confusion the InvFG explicitly states specific applicable provisions of the acts and regulations, such as references of the Banking Act in article 10.[58]

The Capital Market Act governs the prospectus requirements in conjunction with article 131 of the InvFG, which specifically regulates the UCITS

51 Investment Fund Act 2011, organism for joint investment in shares (UCITS).
52 Investment Fund Act 2011, arts 6 and 115 (Approval of a Merging UCITS approved in Austria).
53 Investment Fund Act 2011, arts 6 and 115, para 1, nos 1-4.
54 Investment Fund Act 2011, ch 2, art 196 (References and Regulations) para 2, no 4.
55 Investment Fund Act 2011, ch 3, arts 5 and 94, para 2, nos 1 and 2.
56 Investment Fund Act 2011, pt 1 (General Provisions), art 3 (Definitions), para 1.
57 Investment Fund Act 2011, art 1, para 2, no 1.
58 Investment Fund Act 2011, ch 1, arts 2 and 10 (General Organizational Requirements), para 6.

prospectus.[59] For example, there are specific rules for illustrating categories of assets in which the UCITS is allowed to invest and other rules that require the UCITS to state whether it is allowed to invest in derivatives.

Article 142 of the InvFG details the requirements for an UCITS admitted in another member state of the EU. Such an UCITS distributing its shares in Austria is required to provide Austrian investors with all information, documents, and changes in the same manner as it is required in its origin member state:

- The client information document (*Kundeninformationsdokument*) of article 134 of the InvFG, and its changes, must be translated into the German language; and
- Irrespective of chapter IX of Directive 2009/65/EG, all information, documents, and changes must be provided for investors in accordance with articles 128, 132, 133, 136, and 138 of the InvFG.

Other information or documents must be in German, English, or another language pursuant to article 7, paragraph 1, of the Capital Market Act.[60] Translations under the second and third items, above, must be made under sole liability of the UCITS and must faithfully recite the content of the original information. The rate of publications of the issue, retail, or repurchase price of the UCITS-shares must be made pursuant to the provision of the origin member state of the UCITS.

Liability. The offeror of such a foreign UCITS is liable for complying with article 142 of the InvFG and can be penalized with an administrative penalty of up to €30,000.[61] In addition, the offeror can be sued for certain actions, such as suppressing unfavorable information or propagating fallacious facts on essential circumstances within a prospectus or a KID of a domestic or foreign investment fund.[62]

AIF. Concerning alternative investment funds (AIF),[63] the prospectus and its amendments must be approved by the representative of the foreign investment company. Thus, the representative is the controlling organ of the prospectus and held liable if it neglects to control with the adequate care of a proper and faithful general manager. Suits against a foreign investment company must be filed at the representative's local competent court of jurisdiction.

59 Investment Fund Act 2011, ch 4, arts 2 and 131 (UCITS Prospectus).
60 Investment Fund Act 2011, art 142.
61 Investment Fund Act 2011, art 190, para 1, no 5.
62 Investment Fund Act 2011, art 189, para 2.
63 AIF are non-UCITS with approval for distribution in Austria.

Prospectus

Prospectus Requirements

In General. When securities are initially offered to the public or when the issuer first applies for admission to the Stock Exchange, a prospectus must be published at least one banking day prior to the offer or an announcement of the listing.[64] All prospectuses must be approved by the FMA prior to publication.[65]

Languages. For securities that are solely offered to the public in Austria or that seek admission only to the Austrian regulated market, the prospectus must be written and published in German, English, or another FMA-accepted language.[66]

However, a prospectus that has been reported to the FMA in compliance with article 18 of EU Directive 2003/71/EC is not required to be published in an FMA accepted language, and may be published in another language which is commonly used in international financial markets. Nevertheless, the FMA may require a summary of such prospectus to be translated and published in German.[67]

Content. The prospectus must contain all information that is necessary to enable investors to make sound judgments on the relevant securities, assets and liabilities, financial standing, costs and benefits, anticipated prospects of the issuer and every guarantor, and any rights that are derived therefrom. This information must be presented in a manner that is easy to dissect and understand.[68]

Furthermore, it must contain information regarding the issuer and the relevant securities, along with a summary. The summary must be published in the original language used in the prospectus, in the form of a brief statement and in simple terms that convey material information and potential risks affiliated with the issuer, any guarantor, and the securities. The summary must be organized to facilitate market research by the investors, with the key information clearly stated and formatted to allow for efficient comparison. The summary must include the following warnings:

- The summary serves merely as an introduction to the prospectus;
- The investors should rely on their own analysis of the complete listing prospectus when reaching an investment decision;

64 *Kapitalmarktgesetz*, art 2, para 1 (Public Offerings Subject to the Obligation to Publish a Prospectus); Stock Exchange Act, art 74.
65 *Kapitalmarktgesetz*, art 10, para 1 (Publication of the Prospectus).
66 *Kapitalmarktgesetz*, art 7b.
67 *Kapitalmarktgesetz*, art 7b, para 3.
68 *Kapitalmarktgesetz*, art 7, para 1.

- Pursuant to EEA member state national legislation, the investor must bear and pay any translation costs of a disputed prospectus prior to the start of legal proceedings, where an investor files a claim arising from information contained in a listing prospectus with a court; and
- Those who provided the requested summary and its translation are only liable to the aggrieved party if the summary is misleading, false, or inconsistent when read conjointly with the complete listing prospectus.[69]

If the securities' final issuing price and volume have not been determined, the prospectus must contain either the criteria and/or conditions used to determine the price and volume and the market price respectively, or permission to withdraw the relevant purchase or subscription of the securities within no less than two banking days after the final issuing price and volume are filed with the FMA.[70]

Issuers with Registered Seat in Non-European Economic Area State. The FMA may permit a prospectus offered by a non-EEA member state provided that the prospectus has been completed in compliance with the third country's federal law, and the international standards established by the international securities commission organizations, including the International Organization of Securities Commission (IOSCO) standards for disclosure, and the key investment information duties are equivalent to the requirements provided by the Capital Market Act.[71]

Cooperation in European Economic Area. The issuers must refer to the information required by the current amended rules of Company Law Directives 2003/71/EC and 2004/109/EC and Regulations EU 1606/2002 and 809/2004 on the application of international accounting standards.

In the event of a third-country issuer, the home FMA must provide the host EEA member state and the European Securities and Markets Authority (ESMA) with a certificate of approval of the prospectus that confirms that the prospectus was in compliance with Directive 2003/71/EC.

The notification must be published either within three banking days of the approval of the prospectus if the issuer requested approval after the submission of such prospectus, or within one banking day of approval if the issuer submitted a request with the prospectus.

The FMA may notify the competent EEA state's listing authority and the ESMA about any violation of the relevant provisions by an issuer with its registered

69 *Kapitalmarktgesetz*, art 7, para 2.
70 *Kapitalmarktgesetz*, art 7, para 5.
71 *Kapitalmarktgesetz*, art 7c.

seat in this EEA member state or by its financial intermediaries. If the violation continues despite the measures exercised by the competent authority of the home country, the FMA is entitled to take all necessary measures to protect the investors' interests after informing the competent authority and the ESMA. The FMA is required to report such proceedings as soon as possible to the European Commission and the ESMA.[72]

Exemptions from Obligation to Publish Prospectus. If the application for admission to listing on the exchange is made for certain securities as defined in article 75 of the Stock Exchange Act, ie, shares issued in substitution for others already listed on the same exchange without raising the company's capital, a prospectus is not required.[73] Additionally, article 3 of the InvFG stipulates additional exemptions from the obligation to publish a prospectus.

Omission of information. The FMA may issue an official notice to authorize the omission of certain information in the prospectus, which must be included pursuant to the Capital Market Act or the current version of EU Regulation 809/2004 provided that:

- The disclosure of such information would be adverse to the public interest;
- The disclosure of such information would be seriously detrimental to the issuer, so long as the public would not likely be misled regarding essential facts and circumstances necessary for reaching an educated judgment of the issuer, the offeror, or the guarantor and the rights related to the securities mentioned in the prospectus; or
- The information is irrelevant merely for the purpose of a special offer or admission to trade on a regulated market and does not influence one's judgment on the financial standing and future prospects of the issuer, the offeror, or the guarantor.[74]

Examination of Prospectus. To ensure accuracy and integrity, the required prospectus for public offerings must be scrutinized by one of the credit institutions or associations specified in article 8 of the Capital Market Act. The FMA is authorized to utilize services of such credit institutions or associations, when evaluating a prospectus for approval. The FMA must approve the prospectus provided that it is complete, intelligible, explicit, and in compliance with the requirements set forth in the Capital Market Act.

The FMA is entitled to delegate the approval of the prospectus to the competent authority of another EEA member state, provided that the ESMA is given notice

72 *Kapitalmarktgesetz*, art 8c.
73 Stock Exchange Act, art 75, para 1, no 2.
74 *Kapitalmarktgesetz*, art 7, para 6.

in advance and such competent authority accepts such delegation.[75] Following admission to the listing on the exchange, the FMA is entitled to:

- Require full disclosure, by the issuer, of all relevant information which may influence the valuation of the securities, so that investors are protected;
- Suspend or request the relevant regulated market to suspend trading of the securities, if the FMA believes the issuer's status may cause trading to result in injuries to investors' interests;
- Certify that the issuer complies with the conditions pursuant to articles 102 and 103 of Directive 2001/34/EC and that the investors in every EEA member state, where the securities are offered, receive identical information and equal treatment by the issuer; and
- Perform on-site inspections to confirm compliance with the relevant capital market act provisions and the relevant Directive 2003/71/EC implementation measures.[76]

Publication of Prospectus. The prospectus is considered available to the public when:

- Published in the *Amtsblatt zur Wiener Zeitung* (*Official Bulletin of the Republic of Austria*) or in at least one newspaper which is circulated nationwide;
- Published in printed form made available to the public without charge, at the competent authorities of the relevant market, at the registered office of the issuer, or at the financial intermediaries, including the paying agents;
- Published electronically on the issuer's website and, if applicable, on the website of the financial intermediaries, including the paying agents;
- Published electronically on the website of the regulated market for which an application for the admission to listing is filed; or
- Published electronically on the FMA's website or on the website of an organization entrusted with this task, if the FMA opted to offer such service for an appropriate fee.[77]

In any case, the issuer must publish a public notice, provided that Austria is the home member state, in the *Official Bulletin of the Republic of Austria* or in at least one newspaper circulated nationwide. The notice must indicate how the prospectus was published for public access and where it may be obtained.[78] Any new material fact, crucial error, or inaccuracy relative to the information contained in the prospectus, which has the potential to influence the evaluation

75 *Kapitalmarktgesetz*, art 8a, para 6.
76 *Kapitalmarktgesetz*, art 8a, para 8.
77 *Kapitalmarktgesetz*, art 10, para 3.
78 *Kapitalmarktgesetz*, art 10, para 4.

of the securities, and which emerges between the period of approval of the prospectus and the time either before the final closing of public offering or after trading on the regulated market has commenced, must be disclosed in an addendum published by the applicant. The rules concerning publication of the prospectus also govern the publication of an addendum; additionally, the latter must be forwarded to the FMA for examination and approval at the same time it is published.

Provided the supplement satisfies the necessary conditions, the FMA must approve it within seven banking days after the date it was received. The FMA must send a duplicate of the approval to the Notification Office.[79] If a change must be made to the addendum during the supplementary approval process, such change must be published, along with the already published rectification notice. If necessary, all summaries or translations must be modified to incorporate the information included in the addendum.[80] Investors are entitled to revoke their purchase order or subscriptions to securities within two business days after the supplement is published, if it is made prior to any newly emerged facts, and before the publication of the relevant addendum.[81]

Advertising. Advertisements of any kind mentioning a public offer of securities or the admission to listing on the exchange must be in compliance with the following provisions set forth in article 4 of the Capital Market Act:

- All advertisements must disclose that a prospectus, including any modified or appended information, has been published or will be published and must indicate where the prospectus is made publicly available.
- All advertisements must be freely advertised. The information communicated through advertisements must be accurate and may not be misleading. Additionally, such information must be consistent with the information provided by the prospectus or any supplementary information if already published, or with the required content for a prospectus, if is published after the advertisement.
- All information relative to the public offerings or the admission to listing to the exchange must be consistent with the information provided in the prospectus or any supplements, regardless of whether it is conveyed in writing or orally for purposes other than advertising.

If no prospectus is required, key information presented by an offeror to qualified investors or specific categories of investors must be disclosed to all relevant qualified investors or specific categories of investors. This condition is not

79 Capital Market Act, art 12; The Notification Office is the *Oesterreichische Kontrollbank Aktiengesellschaft* (OeKB).
80 *Kapitalmarktgesetz*, art 6, para 1.
81 *Kapitalmarktgesetz*, art 6, para 2.

applicable when the issuer or applicant is required to publish a prospectus. The FMA is authorized to monitor and enforce compliance with the above-mentioned advertising standards, especially when there are legitimate suspicions that these advertising standards are being violated.[82]

In addition, article 40 of the Securities Supervision Act sets forth provisions regarding the necessary information provided by a legal entity to actual and potential clients, regardless of whether the clients are classified as private, retail, or professional clients.

These provisions apply to all information concerning the relevant financial instruments or investment services, pertaining to an offer of investment services for commercial or non-commercial purposes. Such provisions also apply to a marketing announcement if its focus is on sales promotion, which can be derived from form and content, ie, business portfolios, product information, advertising information on websites, printed ads, customer magazine, newsletters, and the like. Marketing announcements must be:

- Clearly identifiable as such;
- Explicit;
- Accurate;
- Not misleading; and
- Parallel with other information of the announcing legal entity.

If the disseminated information or marketing tool may potentially reach private clients, such communication must include reference to the concomitant risk and the proportionality of advantages and risks must be obvious.[83]

Liability for Contents of Prospectus. Investors are entitled to claim damages arising out of their reliance on the accuracy and integrity of the relevant facts necessary for evaluating securities or investments and that are provided in the prospectus, including mandatory addendums, supplements, and amendments. The following scenarios may cause liability when:

- The issuers provide false or incomplete information for which they are responsible themselves, or their agents whose services were utilized to compose the prospectus are responsible. This also applies to foreign issuers of investments or securities that are required to publish a prospectus within Austria.
- The prospectus auditors provide false or insufficient audits for which they are responsible for themselves, or their agents whose services were utilized to conduct the audit of the prospectus are responsible.

82 *Kapitalmarktgesetz*, art 4.
83 *Wertpapieraufsichtsgesetz*, arts 40 *et seq*.

- The prospectus auditors approve investment prospectuses (*Veranlagungen*) which include any false or inadequate scrutiny because of gross negligence attributed to either the auditors or their agents whose services were utilized to perform the audit.
- The *Wiener Börse AG* approves prospectuses of securities admitted to listing on the Stock Exchange whose information fails to satisfy article 8, paragraph 2c, of the Capital Market Act, resulting in gross negligence attributed to either the entity or its agents whose services were utilized to draft the statements pursuant to article 8.
- Persons who, regardless of whether in their own name or on behalf of third parties, have accepted the investor's contract offer, and the contract broker, if the person acting as a mediator is professionally engaged in trading or mediating securities or investment dealings and these persons or their agents knew or were ignorant due to gross negligence of the inaccuracies or deficiency of the information or audit.
- The auditor of the annual accounts provided and confirmed an audit opinion for such accounts for the purpose of publication in the prospectus, while knowing of such inaccuracies and deficiency of the annual accounts.

Liability for the damages is not severable. Thus, liability is not reduced if more than one of the mentioned parties is found liable. Each party is liable for the full amount in damages. Such liability towards investors may not be waived, proscribed, or limited in advance to the detriment of the investors. Claims under the Capital Market Act must be filed with the court within 10 years after the end of the offering which requires publication of a prospectus; failure to file within the allocated time will result in the barring of the claim.[84]

The claim for damages will not be compensated if such damages derive merely from the fact that securities or investments were not obtained due to inaccurate or insufficient information published in the prospectus. In the absence of intentional acting on behalf of the wrongdoers, each individual investor is only entitled to damages totaling the purchase amount paid, including fees, and interest since the date of purchase. If such acquisition was not paid for, the damages are limited to the last amount paid, including fees, and interest since the date of receipt. These provisions are not applicable to claims for damages resulting from other legal violations or breaches of contract.

Penal Consequences. Violations of the Capital Market Act's prospectus provisions may result in penal consequences according to article 15. A person who, in connection with a public offering of securities or investments that are subject to the obligation to publish a prospectus pursuant to the Capital Market

84 *Kapitalmarktgesetz*, art 11.

Act, offers securities or investments for which no approved prospectus, modifications, or supplements to the information audited pursuant to article 6 have been published in a timely manner; gives incorrect commendatory information regarding material circumstances in the meaning of article 7 or conceals adverse facts in a published prospectus, in the changed or supplementary information pursuant to article 6 with a view to influencing the decision on the acquisition; in violation of the provisions of article 14, does not publish a statement of accounts, or financial statements published pursuant to article 14 gives incorrect commendatory information regarding material circumstances in the meaning of article 7 or conceal adverse facts, will be punished by law to a prison sentence of not more than two years or to a fine of not more than 360 times the daily fine rate as set by the court unless the violation is more severely punishable by other laws.

If a person commits either of the first two violations above, he may avoid the penalties if he voluntarily prevents the receipt of securities or investments prior to the submission of payment. The offender shall also not be punished if the payment is not made without any effort on his part, but the offender, though not knowing of this, has voluntarily and seriously made efforts to prevent the acquisition. The party liable for compensation may ward off such penalties by compensating the aggrieved party for the purchase price of the securities or investments, including additional fees and expenses.

Consumer Transactions. If an issuer offers securities or investments and fails to publish a mandatory prospectus or an addendum, respectively, the investors who are classified as consumers, as defined in the Consumer Protection Act, are entitled to revoke their bid or void the contract.[85]

This right to rescind the contract must be in writing within one week after the publication of the prospectus or the addendum. Any agreements contrary to the provisions of article 5 of the Capital Market Act to the detriment of the consumer are invalid.[86]

Takeover Law

Public Takeover Bids

In General. The Takeover Act sets out the rules, procedure, and supervision requirements of takeover bids according to the following principles:

- Equal treatment of all shareholders of the target company;
- Protection of shareholders in case of taking control of a company;
- Full information of the shareholders;

85 *Kapitalmarktgesetz*, art 15.
86 *Kapitalmarktgesetz*, art 15, para 5.

- Protection of the interests of all shareholders, employees, and creditors of the target company and of public interests;
- Prevention of the creation of false markets by simulated influence on the stock price and by corruption of the markets' operation; and
- Fast takeover transactions.[87]

The Takeover Act established the Takeover Commission, an authority with the competence to supervise the application of the takeover rules, to draw up official statements, and to initiate proceedings on its own behalf.[88]

Territorial Application. The requirements stated by the Takeover Act apply to any takeover bid where the target company has its registered office in Austria and its shares are listed on a regulated market of the Stock Exchange. Part 4 of the Takeover Act provides requirements for foreign bidders.

The following rules of the Takeover Act also apply to public offers for the purchase of voting shares issued by a stock corporation registered in Austria, if the shares are not listed on a market of the Stock Exchange but on a regulated market of another member state of the EU or the EEA and the bid would be subject to the Takeover Act if the shares were listed on a regulated market[89] in Austria:

- General aspects;
- Procedure of the takeover commission,
- Sanctions that may be imposed;
- Information on the employees of the target company;
- Prohibition of prevention (V*erhinderungsverbot*);[90]
- Impartiality rule (O*bjektivitätsgebot*);
- Duty to make an offer and the exemption;
- Duty to notify a controlling interest;
- Infringement of the secured blocking minority (*gesicherte* s*perrminorität*);
- Declaratory proceedings (f*eststellungsverfahren*);
- Amendment of statutes; and
- Lifting of restrictions (*Durchbrechung von Beschränkungen*).[91]

87 Takeover Act, art 3.
88 Takeover Act, art 29, no 1.
89 Takeover Act, art 27b, para 1.
90 Supervisory and management boards are prohibited from taking actions preventing the shareholders from being free in taking decisions on the offer.
91 Takeover Act, art 27b, para 2.

Voluntary Bids. To avoid insider trading and the creation of false markets, the offeror has the duty to keep his intention to make a bid confidential. When the offeror is considering making or intending to make a bid or to act in such a way that it will be under an obligation to make a bid, it shall immediately disclose the matter and inform the administrative organs of the offeree company if there is a substantial movement in the price of the equities or rumors and speculations concerning the bid arise and there are reasonable grounds for concluding that these originate in the preparation of the bid, the plans of the offeror to make such a bid, or in the purchase of shares by the offeror.[92]

The offeror may inform the administrative bodies of the offeree company of its plans or its intention to make a bid before these are disclosed and may enter into negotiations with them.[93] During the negotiations, the offeree company and its shareholders also must ensure confidentiality, as well as immediate disclosure in the case of substantial price movements of the shares and takeover rumors.[94] The offeror must draw up the offer documents with the following information:

- The terms of the bid;
- Particulars of the offeror including, if the offeror is a company, its type, name, and registered office; in addition, particulars of direct or indirect holdings in the offeror company as defined in articles 91 *et seq*. of the Stock Exchange Act, and its affiliation to a group of companies;
- The equities which are the object of the bid;
- The consideration offered for each security and the method of valuation used for determining said consideration and, in the cases mentioned in article 26 of the Takeover Act, the base of the calculation; in addition, details on the conduct of the bid and, in particular, on the agents authorized to receive acceptances and pay out the consideration;
- Where applicable, the maximum and minimum percentages or quantities of equities which the offeror undertakes to acquire and a description of the rules of allocation as specified in article 20 of the Takeover Act;
- The offeror's shares in the offeree company and those already held by the parties acting in concert or the shares they are entitled to or obligated to acquire in the future;
- All conditions and rights of withdrawal to which the bid is subject;
- The offeror's intentions regarding the future business of the offeree company, and in so far as it is affected by the bid, the offeror company and with regard to the safeguarding of the jobs of their employees and management, including any material change to the conditions of employment, in particular, the

92 Takeover Act, art 5.
93 Takeover Act, art 6, para 1.
94 Takeover Act, art 6, para 2.

offeror's strategic plans for the two companies and the likely repercussions on employment and the locations of the companies' place of business;

- The period for acceptance of the bid and for the delivery of the consideration;
- Where consideration is offered in the form of equities, the particulars thereof as specified in article 7 of the Capital Market Act and articles 74 *et seq*. of the Stock Exchange Act;
- The conditions under which the offeror is to finance its bid;
- Information on any parties acting in concert with the offeror, or if known to the offeror, with the offeree company and, in the case of companies, their types, names, and registered offices and relationships with the offeror and, where possible, with the offeree company; information on the legal entities controlled by the offeror (article 1, fig 6, second sentence, of the Takeover Act) may be omitted if the controlling entity is not of significance for the decision of the recipients of the bid;
- Information on the compensation offered for rights which might be removed as a result of the breakthrough rule[95] as well as details on the form of payment of the compensation and the method according to which it is determined; and
- Information on the national law that will govern contracts concluded between the offeror and the holders of the offeree company's securities as a result of the bid and the competent courts.[96]

A bid may be made subject to conditions or rights of withdrawal if these are objectively justified, in particular, if they result from legal obligations of the offeror, or if the application of the condition or the exercise of the right of withdrawal does not depend entirely on the offeror's discretion. [97]

The offer documents must be examined by an Austrian credit institution, a certified auditor, or by the domestic branch office of a credit or financial institution with its seat in another EEA member state and authorized to provide such services in its member state of origin. The examining person or entity (expert) must certify that the documents are complete and in compliance with the law and that the bidder has the means to finance the offer. The offeror may notify the offer documents and the expert's report to the Takeover Commission and make all the information public between 12 and 15 trading days after the Takeover Commission receives the offer.[98]

Foreign offerors must nominate an Austrian agent authorized to accept the necessary documents. The agent can be a person or legal entity permitted to examine takeover documents, a lawyer, or a public notary. Before publication,

95 Takeover Act, art 27a.
96 Takeover Act, art 7.
97 Takeover Act, art 8.
98 Takeover Act, art 9.

the offer documents and the expert's report must be transmitted to the managing board and the chairman and vice chairman of the offeree company. The Takeover Commission may give an official statement on the documents or prohibit the public offer if it is unlawful.[99]

The offer and the expert finding must be published either in a newspaper distributed in Austria or in a brochure provided to the public for free at the seat of the company no earlier than the twelfth and not later than the fifteenth trading day after receipt by the Takeover Commission, unless the Takeover Commission has prohibited the publication of the bid. If the offer has not been published in its entirety in the *Official Gazette*, information on where to obtain the documents or where the offer has been published must be circulated in the Austrian market. Should the offeror or the offeree company have a website, the documents shall also be placed on the website without delay and in a manner that makes them easy to find.[100]

The management and supervisory board of the target company must guarantee the shareholders opportunity to make a free and informed decision on the offer. They are prohibited from taking measures to frustrate the bid, unless the general meeting has decided to do so after gaining knowledge about the bid. The management board of the offeree company must prepare a response to the offer containing a statement on whether the offer serves the interests of the shareholders, the employees, and the creditors of the target company.[101] An expert appointed with the consent of the supervisory board of the target company must examine the bid, the response, and any response of the supervisory board and must provide a report.[102]

The management board and the supervisory board of the offeree company shall publish a response stating reasons on the bid immediately after the publication of the offer documents. The response shall contain, in particular, an assessment of whether the consideration offered and the other terms of the bid take adequate account of the interests of all shareholders and other holders of equities, and what the probable effects of the bid would be on the offeree company based on the strategic planning of the offeror regarding the offeree company, especially with respect to employees (jobs, working conditions, and the fate of the locations), on creditors, and the public interest. Should the management board or supervisory board be unable to give a final recommendation, they must in any case outline the arguments for accepting or rejecting the bid, highlighting the most important features.[103]

During the bid period, the offeror may improve the consideration offered or otherwise change the bid to the benefit of holders of equities. An improvement

99 Takeover Act, art 10.
100 Takeover Act, art 11, para 1a.
101 Takeover Act, art 12.
102 Takeover Act, art 13.
103 Takeover Act, art 14.

is not permitted if the offeror has declared that it would by no means make an improvement; this may not apply if a competing bid exists or if the Takeover Commission has authorized an improvement on the bid.[104] From the date of disclosure of the intention to make a bid or of a notification, the offeror and any parties acting in concert shall refrain from making any declarations designed to achieve the acquisition of equities of the offeree company under more favorable conditions than those set out in the bid unless the offeror improves the bid or the Takeover Commission grants an exemption for significant reasons; in all cases, such declarations must be disclosed immediately.[105] Anyone having a specific interest in the outcome of the bid may notify the Takeover Commission of any acquisitions or sales of the securities of the target company.

When a competing bid is published, the holders of shares shall be entitled to withdraw from any previous declarations of acceptance of the original bid until at the latest four exchange trading days before the original acceptance period expires.[106] If several bids have been made and one of them has been improved on, the shareholders have the right to withdraw from previous declarations of acceptance for the other bids.[107]

The bidding period must last at least two weeks and may not end earlier than 10 weeks after the publication of the offer documents. The Takeover Commission may define a shorter bidding period, but only with the offeror's permission can the period be shorter than six weeks.[108] The offeror may extend the bidding period unless he pledged not to do so. In the case of competing offers, the bidding period must last at least two weeks and may not end before the ending of the primary offer's bidding period.[109] At the end of this period, the offeror must make the results of the bid public.[110]

If, in a partial bid involving the acquisition of a certain percentage or a certain number of the shares of the offeree company, the number of shares for which declarations of acceptance have been submitted is higher than the number of shares the offeror wishes to acquire, declarations of acceptance shall be allocated on a pro rata basis. The declaration of acceptance made by each shareholder shall be taken into account in the same proportion as the ratio of the partial bid to the total of acceptance declarations received. The offeror may in the offer documents specify exceptions in order to avoid odd numbers of shares.[111]

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104 Takeover Act, art 15.
105 Takeover Act, art 16.
106 Takeover Act, art 19, para 1.
107 Takeover Act, art 17.
108 Takeover Act, art 19, paras 1 and 1a.
109 Takeover Act, arts 19 and 21, para 1b.
110 Takeover Act, art 19, para 2.
111 Takeover Act, art 20.

Should a bid to acquire shares fail, the offeror and parties acting in concert shall be excluded from making any further bids for the shares of the offeree company for a period of one year after the publication of the result of the bid. They shall also be banned from acquiring shares during the same period that could trigger an obligation to make a bid.[112]

Mandatory Bids. Anyone who directly or indirectly obtains a controlling interest in an offeree company shall immediately notify the Takeover Commission, and within 20 trading days of obtaining a controlling interest announce a bid for all of the equities of the offeree company in accordance with the Takeover Act. A direct controlling interest is a direct interest held in an offeree company that gives the holder more than 30 per cent of the shares with permanent voting rights.[113]

Should any person acquiring a controlling interest who is not entitled to the majority of the permanent voting shares acquire additional shares within a period of 12 months that give him at least two per cent additionally of the voting rights of the company, he must immediately report this to the Takeover Commission and announce to the offeree company a bid for all of the equities of the company in accordance with the Takeover Act. Acquiring a controlling interest is permissible only if the party making the bid has ensured in advance that he will be able to fulfill the cash consideration and if all appropriate measures have been taken to guarantee fulfillment of any other type of consideration.[114]

In the case of parties acting in concert, the mutually held shares in the other's company shall be added. A share shall be credited to a legal entity unilaterally if the legal entity or any party acting in concert with it can exercise influence over voting rights of third parties directly or indirectly. The adding of shares will apply to any interests held as follows:

- By a third party for the account of the legal entity;
- Over which the legal entity can exercise voting rights without being the owner;
- For which a legal entity has assigned to a third party as collateral if the legal entity can exercise the voting rights without requiring any explicit instructions by the transferee or if the legal entity can influence the exercise of the voting rights by the transferee;
- A legal entity has been assigned *usus fructus,* if the legal entity can exercise the voting rights without any explicit instructions of the shareholder or can influence the exercise of voting rights of the shareholder; and

112 Takeover Act, art 21.
113 Takeover Act, art 22, paras 1 and 2.
114 Takeover Act, art 22, paras 4 and 5.

- A legal entity can acquire by unilateral declaration if the legal entity can exercise the voting rights without any explicit instructions of the shareholder or can influence the exercise of voting rights of the shareholder.

In the above-mentioned cases, the legal entity must be treated equally with the parties acting in concert with it.[115] Voluntary bids that may result in acquiring a controlling interest depend on the offeror's receipt of acceptance agreements containing more than 50 per cent of the voting rights. In the case of an exclusive acquisition or the acquisition of voting rights with parties acting in concert during the ongoing offer period, the acquired voting rights must be added to the voting rights of the acceptance agreement.[116]

A person having acquired a controlling interest who has not caused this to occur by taking any action at a time close to the bid, in particular, by acquiring shares, is not under the obligation to make a bid if at the time of acquiring the shares he would not have had to expect the acquisition of a controlling interest. The acquisition of a controlling interest must be notified to the Takeover Commission immediately, but at the latest within 20 exchange trading days as of the acquisition of the controlling interest. In this case, it may not be possible to exercise more than 26 per cent of voting rights. An enlargement of the investment triggers an obligation to make a bid. After the settlement of such a bid transaction, the restriction on the voting rights no longer applies. The Takeover Commission has the right to suspend voting rights fully or in part upon application of the party involved and instead impose conditions and terms insofar as these guarantee equivalent protection to the other holders of equities. The suspension of voting rights exceeding 30 per cent cannot be rescinded.[117]

A mandatory bid is not allowed to be subject to a condition except this condition is imposed by law. Mandatory bids must provide for the purchase against cash. The payment must occur at the latest 10 trading days after the binding offer. The offeror also may make an offer to trade for other securities.[118]

The price of a mandatory bid or of a voluntary bid to acquire a controlling interest may not be less than the highest consideration in money paid or agreed on for those shares of the offeree company or any parties acting in concert with it within the preceding 12 months before the announcement of the bid. This also must apply to the consideration for shares which the offeror or any party acting in concert with it is entitled or obliged to acquire in the future. Moreover, the price must correspond at least to the average exchange price weighted by the respective trading volumes of the respective equities in the past six months before the day on which the intention to make a bid was announced.[119]

115 Takeover Act, art 23.
116 Takeover Act, art 25a, para 2.
117 Takeover Act, art 22b.
118 Takeover Act, art 25b.
119 Takeover Act, art 26, para 1.

The offeror and all parties acting in concert must immediately disclose any facts relevant to the price determination to the expert examining the offer and to the Takeover Commission.[120] Within three months after the publication of the result of the bid, any shareholder can apply for the verification of the lawfulness of the price by the Takeover Commission.[121]

Exemptions. The mandatory bid obligation does not apply if the share in the offeree company does not give a controlling influence over it or if the legal entity does not change which could exercise a controlling influence when taking the principle of substance over form into account. In such cases, the rules on passive acquisition of a controlling interest do not apply. The facts of the matter must be notified to the Takeover Commission immediately, but at the latest within 20 exchange trading days as of the acquisition of the shares. The share in the offeree company does not transfer any controlling influence in the following cases:

- Another shareholder together with the parties acting in concert holds at least an equal amount of shares with voting rights in the offeree company as the offeror;
- The shares do not transfer a majority of voting rights due to the usual presence of the other shareholders at the general shareholders' meeting;
- The exercise of the voting rights is limited to 30 per cent under provisions limiting voting rights in the by-laws; and
- The legal entity that ultimately has the right to exercise the controlling interest under the aspect of substance over form does not change, especially when:
  - Shares are assigned to a legal entity in which the transferor has a direct or indirect controlling interest; if the shares were held up to now by a group of parties acting in concert, this must apply accordingly if the decision of the legal entity to whom the shares have been transferred cannot be controlled by another legal entity or other group of legal entities;
  - Shares are assigned to a legal entity which holds a direct or indirect controlling interest in the transferor; if the shares are transferred to several legal entities, this must apply accordingly if the decisions of the offeree company cannot be controlled by another legal entity or another group of parties acting in concert;
  - Shares are assigned to a private foundation with a management subject exclusively to the controlling influence of parties having had the controlling interest up to then; and

120 Takeover Act, art 26, para 4.
121 Takeover Act, art 26, para 5.

– Entering into or dissolving an agreement on the exercise of voting rights does not allow any controlling influence over the decisions of the offeree company by another legal entity or another group of legal entities.[122]

Although there is no duty to make an offer, the Takeover Commission must be notified within 20 trading days after obtaining controlling interests if:

- An indirect controlling interest is obtained and the holding's book value is less than 25 per cent of the book value of the net assets of the direct holdings held by the legal entity;
- The shares are purchased for restructuring purposes or as securities for outstanding debts;
- The number of voting rights required for generating a controlling interest is exceeded temporarily or accidentally, provided that the infringement is reversed immediately;
- The shares are obtained by donation between related persons, inheritance, or division of property on occasion of divorce, dissolution, or nullification of a marriage;
- The shares are transferred to another legal entity that is held indirectly or directly by affiliated shareholders; and
- The party excludes (squeezes out) the old shareholders within five months of obtaining the controlling interest if the indemnification is not less than the mandatory bidding price and complies with the highest price for the shares that has been paid or agreed on by the party until the registry with the Commercial Register.[123]

Companies also have the possibility to include restrictions on the transfer of shares in their articles of association. If provided for, the bidder holding 75 per cent or more of the voting rights in the target company is entitled to convoke a shareholders' meeting following the announcement of a takeover bid, and is free to remove supervisory board members delegated by shareholders and to appoint new members (lifting-rule).[124]

Stability Measures for Financial Institutions

Measures Addressing Need for Liquidity in Financial Sector. The Interbank Market Support Act (*Interbankmarktstärkungsgesetz*, IBSG), which came into force on 27 October 2008 in order to re-invigorate the interbank market, expired after a prolongation of its initial time limit of one year on 31 December 2010.

122 Takeover Act, art 24.
123 Takeover Act, art 25.
124 Takeover Act, art 27a.

The IBSG enabled the Minister of Finance to support the interbank market via a company (SPV) with the exclusive purpose of borrowing funds from credit institutions or insurance companies via the interbank market in its own name and for its own account. The SPV loaned these funds to other credit institutions or insurance companies via the interbank market in its own name and for its own account.

Ownership of the SPV is limited to credit institutions, insurance companies, or the statutory bodies of the professional associations' level for the representation of their interests. The SPV forwarded acquired funds to those banks that exhibited a need for liquidity and it received appropriate collateral. In order to create liquidity, the Federal Government could attach a guarantee to these loans to enable the SPV to issue bonds. The Federal Government also could issue guarantees on behalf of credit institutions to facilitate the issuing of securities.

After the ISBG expired, the Regulation of the Minister of Finance, which specifies in greater detail the conditions and requirements for measures pursuant to the Financial Market Stability Act (*Finanzmarktstabilitätsgesetz*) and the IBSG (*Verordnung des Bundesministers für Finanzen zur Festlegung näherer Bestimmungen über die Bedingungen und Auflagen für Maßnahmen nach dem Finanzmarktstabilitätsgesetz und dem Interbankmarktstärkungsgesetz*),[125] which came into force on 31 October 2008, remains in force, but its field of application is limited to measures pursuant to the Financial Market Stability Act, since the ISBG expired.

Equity-Strengthening Measures for Banks. The Financial Market Stability Act, which came into force on 27 October 2008, enables the Federal Minister of Finance to inject equity capital by way of capital increases. In principle, the regulation provides for the use of all forms of permissible equity capital measures for this purpose. The government can impose appropriate conditions for providing equity capital. In special cases and in the interests of the relevant institution, the Government can intervene in the ownership structure.

The flexibility of the legal framework makes it possible to include the individual measures of a state-owned organization. Furthermore, the provisions provide for the Federal Government to transfer holdings associated with the measures described above to private owners once the measures have achieved their objective and when the capital market situation allows it.

Stock Exchange

The Vienna Stock Exchange is the only domestic securities exchange. This is operated by a legal entity under private law (Vienna Stock Exchange AG/*Wiener Börse AG*) licensed by the Federal Minister of Finance.

125 *Federal Law Gazette* II, Number 382/2008.

Registration of Private Placements

Austrian law does not require registration of private placements, ie, offering securities to a relatively small number of private investors or financial institutions. Such placements relieve the issuer from obligations such as the publication of a prospectus. This type of placement differs from a public offer, as the latter makes securities available for the whole marketplace. Still, according to article 13 Capital Market Act, any offer must be notified to the *Oesterreichische Kontrollbank Aktiengesellschaft* (OeKB).

The EU Public Offer Prospectus Directive[126] stipulates that an offer of securities delivered to fewer than 100[127] persons per member state, not including qualified investors, does not qualify as a public offer. Additionally, an offer does not require a published prospectus if it is directed solely to qualified investors.[128] For the purpose of the Public Offer Prospectus Directive, the term 'qualified investors' means:

- Legal entities which are authorized or directed to participate in the relevant financial markets, including, but not limited to, pension funds and their management firms, investment firms, credit institutions, various authorized financial institutions, and insurance companies;
- Regional and national governments, central banks, international and supranational institutions, ie, the European Investment Bank, and an array of other similar international cooperatives;
- Designated natural persons who are residents of a member state, and the state authorizes such persons to be considered qualified investors, subject to mutual recognition and other prerequisites; and
- Designated SMEs, contingent upon certain requirements.[129]

Registration of Secondary Trade

In General. The Stock Exchange is required to supervise trading on the exchange with an electronic or technically adequate surveillance system that guarantees the systematic and exhaustive collecting and assessment of all transmitted data, which facilitates any necessary investigations.

The FMA is entitled to use the surveillance system when conducting investigations pursuant to article 25, paragraph 2, of the Securities Supervision Act 2007, especially in the case of insider trading and ensuring compliance with

126 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

127 150 persons according to art 3, para 1, no 14 of the Capital Market Act.

128 Directive 2003/71/EC, art 3.

129 Directive 2003/71/EC, art 2.

the relevant trading laws.[130] The Securities Supervision Act 2007 states the duty of credit institutions and other market participants to make relevant information available to the FMA.

Order Books. All intermediaries, including both Official Brokers and Non-Official Brokers acting as mediums for the negotiable securities traded on the Unlisted Securities Market, are required to maintain order books in which all orders and any cancellation of orders received are catalogued chronologically.[131] These books must be composed in German. Additionally, all regulations governing bookkeeping relative to registered merchants also apply *mutatis mutandis*.[132]

Contents of Order Books. The intermediaries are required to keep a daily log of the completed transactions in the order books, as well as records of the following information:

- The contracting parties' names;
- A description of the contract's purpose;
- The bargained price;
- The terms of the agreement and, specifically, the type and quantity of goods when goods are being sold;
- The time and place of delivery;
- The payment type;
- The time that the conditions of the contract are fulfilled;
- Whether a transaction was completed on or off the exchange; and
- If applicable, the rescinding of the contract prior to its completion.[133]

The order books may be transcribed or computerized. Transcribed books must be bound, stapled, and each page chronologically numbered, as to ensure that no page is removed or replaced. The intermediary must certify and sign these records daily. Computerized records may either be printed monthly and bound together, to be verified and certified with the intermediary's signature, or electronically stored on an external data device and delivered daily to the Stock Exchange along with a signed verification of the data's integrity.

All order books, including the books of intermediaries whose services or employment are terminated, must be retained for seven years from the date of the last entry recorded by the Stock Exchange and afterwards the books must be

130 Stock Exchange Act, arts 25 *et seq*.
131 Stock Exchange Act, art 60, para 1.
132 Stock Exchange Act, art 60, para 5.
133 Stock Exchange Act, art 60, para 2, nos 1-9.

destroyed.[134] Furthermore, if the contracting parties request certified excerpts, the intermediaries are required to provide such excerpts, containing all things relative to the transaction completed by the requesting party. The requesting party is obliged to pay any costs incurred from retrieving the requested excerpts. In the event of an anonymous transaction, the name of the other party may be omitted pursuant to article 63 of the Stock Exchange Act.

Inspections of Intermediaries' Order Books. The Stock Exchange and the Exchange Commissioners, including any representative of the latter, are entitled to inspect the intermediaries' order books at any time. The contracting parties also are entitled to inspect such sections of the books that pertain to their affairs.

Thus, the inspection may only permit the party to access the information regarding its transactions. In the event of an anonymous transaction, the other party's name may be concealed pursuant to article 63 of the Stock Exchange Act. In the event of a legal dispute, the court may order the order book to be proffered, absent a request by a party. However, only entries which are relevant to the dispute may be exhibited at trial.[135]

Members

Membership in the Stock Exchange is, according to article 15 of the Stock Exchange Act, limited to:

- Credit institutions, according to article 1, paragraph 1, of the Banking Act, which are licensed to carry on any business specified in article 1, paragraph 1, number 7, of the Banking Act;
- Credit institutions in member states of the European Union (EU) other than Austria that (a) are licensed in their member state to provide services according to article A(1)–(3) of the Annex to Council Directive 2004/39/EC or authorized pursuant to article 3, paragraph 1, letter p, of Council Directive 2006/49/EC, with such authorization including the freedom of establishment and services, (b) are in compliance with the capital requirements according to Council Directive 2006/49/EC and, unless the respective company is a local firm, are, as far as the compliance with these regulations is concerned, subject to the supervision by the competent authorities of the member state, and (c) have given notice by the competent authority of the member state, pursuant to article 9, paragraphs 2 or 6, of the Banking Act or article 12 of the Securities Supervision Act 2007;
- Local firms merely require confirmation by the competent authority of the member state or any other evidence with respect to the compliance with the requirements pursuant to article 6 of Council Directive 2006/49/EC;[136]

134 Stock Exchange Act, art 60, para 6.
135 Stock Exchange Act, art 61.
136 Stock Exchange Act, art 15, para 1, no 2, let c.

- Recognized investment firms registered outside the European Economic Area (EEA) member state, pursuant to article 2, paragraph 31(b), of the Banking Act;
- Admitted clearing agents with their registered office or admission in an EEA member state so long as they only participate in clearing/settlement pursuant to article 2, number 33, of the Banking Act;[137]
- Companies licensed to trade as a principal or as an agent for third parties in commodity derivative contracts pursuant to article 1, number 6(e)–(g) and (j), of the Securities Supervision Act 2007, even if their license is not based on the Banking Act;[138] and
- Organizations with their registered office in a third country (section 2, number 8, of the Banking Act) that are licensed to carry out at least one of the businesses pursuant to article 1, paragraph 1, number 7, letters b–f, of the Banking Act.

The Banking Act defines credit institutions as holders of an Austrian banking license, pursuant to article 4 of this Act, or pursuant to applicable provisions under Austrian federal law. For the purposes of the Act, banking business encompasses securities business, as most of the latter become members of the Stock Exchange.

Under the Investment Services Directive, credit institutions, investment firms, and local firms whose registered office is located outside of Austria in an EEA member state may be admitted as members to the Stock Exchange if they are allowed to conduct securities business in their member state and are subject to supervision by their competent authorities. Such competent authorities may notify the Stock Exchange of the relevant facts, which decides on the applicant's membership. Investment firms with a registered office in a non-EEA state may be admitted to the Stock Exchange if:

- They are licensed to conduct transactions;
- They are authorized in a third country that is a member of the Basel Committee of Banking Supervision; and
- They are subject to supervision requirements that are at least equal to the investment firm standards in the EU.

Undertakings with their registered office in a third country may be admitted to the Stock Exchange, provided that the applicant is licensed to carry out at least one of the specified businesses there and the applicant satisfies all legal duties. Membership in the exchange requires that:

- There are no facts known which indicate that the applicant might not be as reliable as necessary to be able to take part in trading on the exchange;[139]

137 Stock Exchange Act, art 15, para 1, no 5.
138 Stock Exchange Act, art 15, para 1, no 6.
139 Stock Exchange Act, art 14, para 1, no 1.

- The applicant is not restricted in its capacity to do business, in particular due to insolvency or because it has been put under receivership;[140]
- The applicant or one of its officers has not been convicted by law for an offence under article 13 of the Business Code (*Gewerbeordnung,* GewO), unless such violation is insignificant or the sentence has become expunged from the criminal record;[141]
- The applicant or one of its officers has not been sentenced finally and conclusively pursuant to article 48, 48b, and 48c of the Stock Exchange Act, unless the violation of article 48 or 48(c) is insignificant or the sentence has become expunged from the criminal record;[142] or
- There are no facts known that would be detrimental to the reputation of the domestic market or hinder the maintenance of orderly and fair trading;[143]
- The applicant joins an existing trading and settlement system or a suitable settlement and clearing system pursuant to article 15a of the Stock Exchange Act[144] and deposits the respective collateral;[145] and
- The applicant nominates at least one dealer who will either participate in the trading on the floor or has access to the automated trading system.[146]

Admitted firms, including investment firms, may retain their membership with a securities exchange so long as the following remain in place, even if their registered office is in a state which is neither an EEA member nor represented in the Basel Committee for Banking Supervision only as long as:

- At least one authorized clearing participant[147] is represented on the derivatives market; and
- At least one authorized credit institution is represented on the cash market that has its registered office in a member state and is licensed in said state; or
- A third country is represented in the Basel Committee for Banking Supervision and is a member of the domestic securities exchange and concludes deals on their behalf and guarantees *vis-à-vis* the exchange operating company the fulfillment of exchange transactions carried out by the recognized investment firm or the company that is a member of the domestic exchange.[148]

140 Stock Exchange Act, art 14, para 1, no 2.
141 Stock Exchange Act, art 14, para 1, no 3.
142 Stock Exchange Act, art 14, para 1, no 4
143 Stock Exchange Act, art 14, para 1, no 5.
144 Stock Exchange Act, art 15, para 3.
145 Stock Exchange Act, art 15, para 3, no 1.
146 Stock Exchange Act, art 15, para 3, no 2.
147 Regulation (EU) no. 575/2013, art 300, no 3.
148 Stock Exchange Act, art 15, para 4.

Market Segments

According to certain criteria, the financial instruments traded on the markets of the *Wiener Börse AG* are allocated to various market segments. The market segmentation does not take into account whether financial instruments are admitted to listing on a regulated market (ie, Official Market or Second Regulated Market) or traded on a Multilateral Trading System (ie, Third Market). In particular, the following criteria are relevant for the allocation to the different market segments:

- Markets (official market, second regulated market, or third market);
- Type of financial instruments (shares, participation certificates, bonds, or certificates);
- More stringent reporting, quality, and disclosure requirements;
- Liquidity provider (specialist or market maker);
- Trading system and type trading.

Listing and Delisting

Securities Requirements

Admission to Listing of Official Market. The securities must have a total nominal value of at least €2.9 million for shares and of €725,000 for other securities. For the admission of no-par value securities, the issuer must certify that the market value is predicted to reach at least €725,000 and the total number of such securities must be at least 20,000. For non-voting preferred shares issued by Austrian stock corporations whose ordinary shares are not admitted to listing on the Official Market, the nominal value of the preferred shares must exceed €1 million.[149] These conditions do not apply to the admission of subsequent listings of the same type of securities or for admission of debt securities that are issued continuously free from any restriction to a subscription period or a certain maximum amount.

Debt securities of an international organization that is an entity under public law must be tradable without any restrictions in order to be admitted to listing on the Official Market and the application for admission to listing must refer to all debt securities of an issue. Debt securities issued by the federal government, the provinces, and the member states of the EEA must be admitted to official listing on all securities exchanges.[150]

The denominations of the securities and the number of certificates must correspond to trading requirements and the needs of potential investors. The application for admission must refer to shares already issued or for all securities

149 Stock Exchange Act, art 66a, para 1, no 2.
150 Stock Exchange Act, art 66a, para 5.

of the same offering. Shares that are legally restricted from trading for a certain period may be excluded from admission, provided that such exemption does not prejudice the bearers of the shares to be admitted, and the prospectus or the decree announcing the admission refers to this exception.[151]

Furthermore, the securities must have sufficient distribution among the general public. For publicly owned shares, the minimum requisite is a nominal value of €725,000. In the case of no-par value shares, there must be at least 10,000 publicly owned shares or they must be offered to the public for purchase.[152] These requirements are not applicable if the shares have already been admitted to the official listing of one or more foreign exchanges and an adequate distribution exists outside the country, or in the case of subsequent listing of further securities of the same type.

For securities that grant holders the right to convert or subscribe to other securities having a minimum denomination of less than €50,000, the securities to which the right of conversion or subscription refers must be admitted to listing on the exchange by the latest simultaneously; this requirements may be waived if the issuer furnishes proof that the bearers of the securities that grant them the right to conversion or subscription with a minimum denomination of less than €50,000 have all the information at their disposal that they need to reach an informed judgment of the value of the securities to which the right of conversion or subscription refers; this must be assumed, above all, if the securities to which the right to conversion or subscription refers are officially listed on an internationally recognized securities exchange and the prospectus for the admission to listing of the securities with conversion or subscription rights meets the requirements of article 7 of the Capital Market Act.[153] Certificates that represent shares may be admitted if:

- The issuer meets the requirements of article 66a, paragraph 1, numbers 1–3, of the Stock Exchange Act;
- The certificates meet the requirements of article 66a, paragraph 1, numbers 4–8, of the Stock Exchange Act; and
- The issuer guarantees the fulfillment of its obligations *vis-à-vis* the bearers of the certificate.[154]

Securities Admission Procedures

Applications for admission to listing of a security or of an issuing program on the Official Market and on the Second Regulated Market must be made in writing to the exchange operating company by the issuer and must be signed

151 Stock Exchange Act, art 66a, para 1, no 6.
152 Stock Exchange Act, art 66a, para 7.
153 Stock Exchange Act, art 66a, para 1, no 8.
154 Stock Exchange Act, art 66a, para 6.

by an exchange member if the issuer is not a member of the exchange concerned.[155]

The application must include the applicant's name and registered office, the type and designation of the securities, and the aggregate value of the issue requesting admission. The value should be listed in terms of the nominal value or, in the case of no-par value securities, the quantity of securities and their anticipated fair market value.[156] The following documents must be submitted simultaneously with the application:

- Valid copy of the articles of association or the issuer's partnership agreement;
- Excerpt not older than four weeks from the commercial register in which the issuer is registered;
- Official authorization certificates if such are required for the formation of the issuer's company, the objective of its business activities, or the issue of securities;
- Evidence of any other legal requirements for the issue of securities;
- Evidence of registration of the issue in a register, if such registration is required for the issue to be legitimate;
- Annual audited reports coupled with the auditor's assessment, along with the annual report for the last complete business year; however, in the event of the initial admission to listing on the official market for shares, the first two requirements are applicable in addition to the financial accounts for the past three complete business years;
- Two copies of the prospectus approved pursuant to article 74 of the Stock Exchange Act or Directive 2003/71/EC, together with the FMA confirmation of notification receipt (*notifizierung*);
- If securities are printed, two sample prints of each of the designations for which admission is applied; and
- If the relevant securities or certificates are to be secured by a global certificate, the issuer's declaration of which depository has dominion of such global certificate.[157]

The Stock Exchange must decide on the application within 10 weeks after submission. The issuer filing the application is required to provide the Stock Exchange with any information that might be necessary to determine whether the conditions for the admission to trading on the exchange exist. An appeal may be filed with the Federal Administrative Court (*Bundesverwaltungsgericht*) to

155 Stock Exchange Act, art 72, para 1.

156 Stock Exchange Act, art 72, para 2. Other rules may apply for an application for admission to listing of an issuing program.

157 Stock Exchange Act, art 72, para 3.

challenge the denial of admission to the listing or the revocation of the admittance of listing.[158]

Pursuant to article 47 of Directive 2004/39/EC, the FMA is required to maintain a register of all domestic regulated markets, ie, the Official Market and the Unlisted Securities Market. The FMA must deliver the register to the European Commission and the other member states.[159]

Admission to Unlisted Securities Market

In general, the rules determining admission to the Official Market also apply to the Unlisted Securities Market (the Second Regulated Market). However, the rules differ with regard to how old a stock company must be upon the admittance of its shares. On the Unlisted Securities Market, the stock company must have existed for a period of at least one year, whereas the Official Market requires at least three.

The securities must have a minimum total nominal value of €725,000. For the admission of no-par value securities, the issuer must certify that the anticipated market value is at least €362,500 and the total number of such securities must be at least 10,000.[160] This restriction does not apply to the admission of shares that have already been admitted to the official listing of one or more foreign exchanges and an adequate distribution exists outside the country and of debt securities issued constantly without being restricted to a subscription period or to a certain limited maximum amount.[161]

In order to have adequate amount of free float the necessary number of shares and other equity securities must be provided for trading on the exchange. To meet this requirement at least €181,250 nominal share capital, or in the case of no-par value shares at least 2,500 shares, must be in the possession of the public or must be offered to the public for sale.[162]

The denominations of the shares and other equity securities must meet trading requirements.[163] The application for admission must include all shares already issued of the same type or for all securities of the same subscription. Shares that are legally restricted from being traded for a certain period of time may be denied admission, provided this exception does not prejudice the bearers of the shares to be admitted, and the prospectus or the decree announcing the admission mentions this exception.[164]

158 Stock Exchange Act, art 64, para 2.
159 Stock Exchange Act, art 76.
160 Stock Exchange Act, art 68, para 1, no 2.
161 Stock Exchange Act, art 68, para 3.
162 Stock Exchange Act, art 68, para 1, no 5.
163 Stock Exchange Act, art 68, para 1, no 7.
164 Stock Exchange Act, art 68, para 1, no 8.

In the case of securities that give the bearer conversion rights or subscription rights to other securities and whose minimum denomination is less than €50,000, those underlying securities must be admitted at the latest simultaneously with these to the exchange; exceptions may be made to this requirement if the issuer furnishes proof that the owners of the securities with conversion rights or subscription rights have all the information at their disposal that is necessary to make a judgment on the value of the underlying securities; this is to be assumed especially if the underlying securities are officially listed on a recognized exchange pursuant to article 4, paragraph 1, number 72, of Regulation 575/2013 and the prospectus for the admission of securities with conversion or subscription rights contains the necessary information in accordance with article 7 of the Capital Market Act.[165]

Securities in the form of certificates may be admitted if the issuer satisfies the conditions outlined in article 68, paragraph 1, numbers 1–3, of the Stock Exchange Act; the certificates meet the requirements of article 68, paragraph 1, numbers 4–9, of the Stock Exchange Act; and the issuer guarantees the fulfillment of its obligations to the bearers of such certificates.[166]

Printing

Individually printed securities must be counterfeit-proof and must facilitate the simple and swift settlement of securities transactions.[167] The FMA is responsible for issuing decrees regulating the print of security certificates based on an expertise drawn up by the exchange operating company taking technological progress into account and also must examine the printed securities as to their compliance with the minimum requirements stipulated in the printing guidelines. The application of additional security characteristics must always be permissible.[168]

If the securities of a foreign issuer do not comply with the FMA printing Directives, the issuer must certify that such securities satisfy the admission requirements in the country of its registered office. Furthermore, the shares will only be admitted under the following circumstances:

- Notice is given to the public that the print does not meet Austrian standards;
- Such deviation from Austrian standards does not jeopardize investors' legitimate interests; and
- The country in which the issuer has its registered office is prepared to admit Austrian securities under the same conditions.[169]

165 Stock Exchange Act, art 68, para 1, no 9.
166 Stock Exchange Act, art 68, para 2, nos 1-3.
167 Stock Exchange Act, art 70, para 1.
168 Stock Exchange Act, art 70, para 1.
169 Stock Exchange Act, art 70, para 2, nos 1–3.

Disclosure Requirements

Periodic Disclosure

Official Trade

An issuer is required to disclose its most recent annual financial report, encompassing the consolidated audited financial accounts and the management board's report within four months after the close of the fiscal year. It is the issuer's duty to ensure that these financial statements are made publicly available for at least five years.[170]

Additionally, the following must be provided: commentary and information of the issuer's legal representatives that confirm that the legal representatives have complied with the applicable accounting standards while drafting the annual financial statements. Furthermore, the legal representatives must provide confirmation that the management board's report represents a fair and accurate view of the issuer's financial position and relevant risks.[171]

Issuers of shares must guarantee that, in their home member state, shareholders have the information and tools necessary to exercise their rights and that the data is accurate.[172] Such issuers also are required to treat all shareholders in comparable positions equally. The joint-stock company must inform the FMA and the public immediately in the event that changes in the rights attached to shares come into effect and important changes occur in the capital structure, meaning that information previously published on that subject is no longer valid as soon as such changes come to its attention.

The joint-stock company must inform the Stock Exchange and the FMA in writing of any intentions to make changes in the company's articles of association or articles of incorporation before or at the latest simultaneously with the call to hold the general meeting which is to decide on the proposed amendments and which must be published.

If a foreign issuer of debt securities has an obligation to publish annual accounts in its home country, the annual accounts also must be published in Austria. The issuer must inform the Stock Exchange in writing, before or at the same time as the call to hold a meeting of a body empowered to make such changes, of any changes planned in its statutes or instrument of incorporation insofar as these changes affect the rights of, eg, the bondholders.

The issuer must publish any changes in the rights of bearers of securities other than stocks immediately, in particular such changes as arise out of

170 Stock Exchange Act, art 82, para 4.

171 Stock Exchange Act, art 82, para 4; VwGH, 11 April 2011, 2010/17/0203 on Stock Exchange Act, art 82, re: annual financial report not published in the correct language in time.

172 Stock Exchange Act, art 83, para 2.

changes in the bond terms or interest rates.[173] Furthermore, the issuer must immediately inform the public of any new issue of bonds and, in particular, of the guarantees furnished for these bonds.[174] If the official listing is for bonds with exchange rights or subscription rights, the issuer must publish all changes in the rights that are attached to the different classes of underlying securities.

Unlisted Trade

Issuers of shares must draw up and publish, within the legal limits, annual accounts, including business reports and suggestions for the distribution of profits. If the annual accounts are not published in time (see text, below), an interim report must be published containing preliminary results of the business year concluded. The reports must be delivered immediately to the Stock Exchange.

The issuer must communicate the content of the propositions to be dealt with at the general meeting to the Stock Exchange at least 14 days in advance. In the event that the annual accounts are not published in time, the Stock Exchange must be informed of the period of extension granted by the supervisory board. The Stock Exchange must be notified at least one month in advance of shares to be withdrawn from the unlisted securities market and this must be published simultaneously in the *Official Gazette* of the *Wiener Zeitung*.

The issuers must inform the Stock Exchange immediately in writing of all significant circumstances concerning shareholders, in particular, general meetings to be held, changes in the statutes (such as capital increase or decrease and changes validated by placing a mark on the share certificate), conclusion of contracts on exclusion of profits or losses, distribution of dividends, invitations to exercise subscription rights, exchange of share certificates, and issuing of new coupon sheets.

Issuers of debt securities must deliver their annual accounts and business reports to the Stock Exchange at the latest 14 days before the general meeting is held. The Stock Exchange must be notified at least one month in advance of shares to be withdrawn from the unlisted securities market and this must be published simultaneously in the *Official Gazette* of the *Wiener Zeitung*.

The issuers are obliged to inform the Stock Exchange immediately in writing of all significant circumstances concerning bondholders, especially of resolutions regarding the conversion of securities, the issue of new interest coupon sheets, and the numbers of securities redeemed or drawn by lots and must publish the information in the *Official Gazette* of the *Wiener Zeitung*.

173 Stock Exchange Act, art 93, para 5.
174 Stock Exchange Act, art 93, para 6.

Interim Reports

Issuers of shares or debt securities are required to produce interim reports regarding the first six months of the business year, immediately after the close of the reporting period, or by no later than two months after such closure. The issuers also must guarantee that these reports are available to the public for at least five years after publication. An interim financial report must contain abridged financial accounts, the management board's half-year report, and affidavits in which the issuer's legal representatives affirm their names and positions.

The legal representatives must verify that, to the best of their knowledge, the abridged financial accounts were prepared in compliance with the applicable accounting standards and that such accounts, along with the management board's report, represent a fair and accurate view of the assets, financial standing, and relevant risks.[175] If the issuer is not obliged to produce consolidated financial statements, the abridged financial accounts must include at least a condensed balance sheet, a compressed profit-loss account, and commentary to the financial statements.

The reporting and valuation standards regarding the production of the annual financial reports apply to the condensed financial accounts. If the issuer is obliged to produce such condensed financial accounts, the abridged financial accounts must be produced in compliance with the IFRS pursuant to Regulation 1606/2002/EEC.[176]

Furthermore, if the interim abridged financial accounts are audited, they must contain the unabridged text of the auditor's opinion. If such accounts are reviewed, they must include the unabridged version of the auditor's review report. However, if the interim reports have neither been completely audited nor reviewed by an auditor, the issuer is required to disclose this fact in its report. The applicable liability attaches to the auditor who performs the review.[177]

The interim report must at least encompass any major events that occurred within the first six months of the fiscal year and their effects on the abridged financial reports. It also must illustrate the essential risks and uncertainties for the remainder of the fiscal year. Moreover, issuers of shares must disclose any major transactions performed by closely related persons or companies, including:

- Dealings with affiliated companies and individuals concluded during the first six months of the current fiscal year and which have had a substantial effect on the company's financial standing or earnings within the period; and

175 Stock Exchange Act, art 87, para 1.
176 Stock Exchange Act, art 87, para 2.
177 Stock Exchange Act, art 87, para 3. Liability is subject to article 275, paragraph 2, of the Companies Act; article 62a of the Banking Act; and article 82, paragraph 8, of the Insurance Supervision Act.

- Changes pertaining to deals with affiliated companies and individuals that were identified in the last annual financial report that may affect the company's financial standing or net operating profit during the first half of the current fiscal year. Issuers of shares that are not obliged to produce a condensed financial report must at least disclose deals with affiliated companies and individuals, as referred to in article 43, paragraph 1, number 7, letter b, of Directive 78/660/EEC. [178]

Credit institutions may use their monthly returns or quarterly reports encompassing assets, capital, and risks, in compliance with article 74 of the Banking Act as a substructure for the interim reports. Insurance companies must disclose the premium income deriving from contributions per insurance class, in addition to its aggregate life insurance contracts, in place of sales and operating results. The report must be accompanied with commentary of their results comprised of information detailing profits, costs, and degree of damages flowing from investments.[179]

The interim report must be written in German; in the event of a third-country issuer, publication in another language accepted by the competent body (eg, the regulator) in the third country or a commonly used language in the relevant international financial affiliations.[180]

Exemptions

The following issuers are exempted from the reporting obligation pursuant to article 82, paragraphs 4 and 87 of the Stock Exchange Act:

- Central states, regional authorities, international bodies under public law to which at least one member state belongs, the European Central Bank, and the national central banks of member states, irrespective of whether they issue shares or other securities; and
- Issuers of debt securities admitted to trading only on a regulated market with a minimum denomination of €100,000 or, in case of debt securities denominated in a currency other than Euros, with a minimum denomination whose value on the first listing equaled at least €100,000.

The following issuers are exempted[181] from the obligation to publish interim financial reports:

- Credit institutions that do not possess shares admitted to trading on the regulated market and that have steadily issued debt securities, provided that

178 Stock Exchange Act, art 87, para 4.
179 Stock Exchange Act, art 88.
180 Stock Exchange Act, art 85.
181 Stock Exchange Act, art 90, paras 2 and 3.

the debt securities' aggregate nominal value does not exceed €100 million and no Directive 2003/71/EC-mandated prospectus has been published; and

- Issuers already in existence on or before 31 December 2003 that have only issued debt securities on regulated markets that are irrevocably guaranteed by the origin member state or its regional authorities.[182]

Ad Hoc Publicity

An issuer with securities admitted to the Official or Unlisted Market is required to immediately disseminate any new developments relative to inside information that are likely to have a significant influence on the prices of the securities or, in the case of bonds, facts that could hinder the issuer's capacity to fulfill its commitments simultaneously to the public, all investors, and the FMA.[183]

These facts must be published in compliance with the applicable communication of information provisions.[184] Furthermore, an issuer of shares admitted to listing on the Official Market or to the Unlisted Regulated Market is required to immediately disclose to the public a declaration on any stock options granted, the resolution of the general meeting, and the duration of any stock buyback programs, immediately preceding the implementation of such programs.[185] The FMA may exempt the issuer from the obligation to publish this information if it serves to prevent the issuer from suffering damages with regard to its legitimate interests. In this case, the issuer must certify that investors will not suffer damages.

Insider Trading

Insider Trading and Fraud

In General. The Securities Supervision Act 2007 became effective on 1 November 2007. It implemented Directive 2004/39/EC, also known as the Markets in Financial Instruments Directive (MiFID), and Commission Directive 2006/73/EC regarding organizational and operating requirements. The MiFID provides for a standardized level of protection for investors and standardized practice conditions for a service provider.

Directive 2014/65/EU on Markets in Financial Instruments, repealing Directive 2004/39/EC (MiFID II), and Regulation (EU) 600/2014 on Markets in Financial Instruments (MiFIR) have been published in the EU *Official Journal*. Member states have two years to transpose the new rules stipulated therein, which will be applicable starting January 2017.

182 Stock Exchange Act, art 90, para 1.
183 Stock Exchange Act, art 48d, para 1.
184 OGH 15 March 2012, 6 Ob 28/12d, re: *ad hoc* publicity and sanctions arising out of the Stock Exchange Act, art 48d.
185 Stock Exchange Act, art 82, para 9.

Regulation 596/2014 on market abuse (Market Abuse Regulation) and Directive 2014/57/EU on criminal sanctions for market abuse (Market Abuse Directive) have been published recently in the EU Official Journal. The Market Abuse Regulation must enter into application in July 2016. Member states have two years to transpose the Directive on criminal sanctions for market abuse. The new rules on market abuse update and strengthen the existing framework to ensure market integrity and investor protection provided by the existing Market Abuse Directive (2003/6/EC) that will be repealed.

The Directive on criminal sanctions for market abuse (Market Abuse Directive) complements the Market Abuse Regulation by requiring all member states to provide for harmonized criminal offences of insider dealing and market manipulation, and to impose maximum criminal penalties of not less than four and two years' imprisonment for the most serious market abuse offences. Member states must make sure that such behavior, including the manipulation of benchmarks, is a criminal offence, punishable with effective sanctions everywhere in Europe.[186]

Reporting Obligations. Institutions subject to reporting requirements may notify the FMA of transactions which use instruments required to be reported promptly and no later than the close of the following banking day. The following institutions are subject to reporting requirements:

- Credit institutions which hold a full banking license in Austria;
- Austrian branch offices of credit institutions, financial institutions, and investment firms;
- The Austrian National Bank (*Österreichische Nationalbank*); and
- Recognized investment firms and corporations whose registered office is located in a third country, provided that they are members of a securities exchange as defined in the Stock Exchange Act, in addition to membership to any cooperation exchange engaged in a stock exchange.[187]

These reports must include the details listed in Table 1 of Annex I of Commission Regulation 1287/2006/EC, ie, firm identification, trading day, trading time buy/sell indicator, trading capacity, instrument identification, maturity date, derivative type, unit price, quantity, and counterparty. Pursuant to the Resolution on Reporting Requirements of Securities 2007, reports must include additional details (eg, unit of marketable securities, open/close mark, market maker mark, and SWIFT code of counterparty).[188]

186 See http://europa.eu/rapid/midday-express-12-06-2014.htm?locale=en.
187 *Wertpapieraufsichtsgesetz*, art 64, paras 1 and 2.
188 Resolution on Reporting Requirements of Securities 2007, art 2.

The reports must be transmitted electronically.[189] When an institution has issued a declaration pursuant to article 13(1), second sentence, of Regulation 1287/2006/EC, they may omit certain sections of their individual report. Credit institutions and investment firms are obliged to gather information about their customer's identity for the purpose of these reports. Additionally, credit institutions are required to ascertain and verify their customer's identity prior to administering any securities transaction with a minimum value of €15,000.[190]

Exemptions. The Securities Supervision Act 2007 exempts the following from reporting duties (however, they are obliged to disclose information to the FMA upon request):

- Investment management companies (pursuant to article 2 of the Investment Funds Act 1993[191]);
- Investment management companies for real estate;
- Employee pension funds; and
- The Austrian National Bank.[192]

Rules of Conduct. According to articles 3 and 4 of the Securities Supervision Act 2007, any person or legal entity that intends to provide investment services in Austria must obtain permission from the FMA. Additionally, the Act provides detailed rules of conduct to prevent insider trading, fraud, and improper manipulation of the market and to ensure adequate protection of the customers.

Persons and legal entities providing business services involving securities or other forms of investment of customer assets, as well as the agents of such persons and legal entities, are specifically prohibited from:

- Marketing via telephone and fax listed or unlisted securities or contracts, without the consent of the subscriber; [193] and
- Sending electronic mail, including sms messages, to consumers without the recipient's prior consent, provided that such message was sent for the purpose of direct marketing or delivered to more than 50 recipients.[194]

189 *Wertpapieraufsichtsgesetz*, art 64, para 3.
190 *Bankwesengesetz*, art 4.
191 *Wertpapieraufsichtsgesetz*, art 64, para 6, still refers to the former InvFG from 1993 (amended by InvFG 2011).
192 *Wertpapieraufsichtsgesetz*, art 64, para 6.
193 *Telekommunikationsgesetz* 2003, art 107, paras 1 and 1a. Such consent may be withdrawn at any time, however, revocation of consent has no effect on the relevant contractual relationship; with respect to marketing phone calls, the caller may not conceal or disguise the identification of the calling number.
194 *Telekommunikationsgesetz* 2003, art 107, para 2.

Prior consent to electronic mail is not required if:[195]

- The sender has acquired the contact information for the communication regarding a sale or a service to his customers;
- The message is conveyed for the purpose of marketing his own comparable products or services;
- Upon the conveyance of the customer's electronic contact details and each subsequent message, a clear and explicit opportunity to refuse communications regarding direct marketing has been provided to such customer; and
- The customer has not declined *a priori* that electronic mail is sent to him, specifically through registration to the listing according to article 7 of the E-Commerce Act.

Inside information and Insider

In General. For the purposes of the Stock Exchange Act, inside information is defined as any precise information consisting of confidential facts, directly or indirectly related to one or more financial instruments, and its disclosure may significantly influence the prices of such financial instruments or their derivatives if made public.[196]

Insiders are persons who, as members of an issuer's administrative, management, or supervisory board, or due to their occupation, profession, duties, or participation in the capital of an issuer, are privy to inside information. Any person having gained inside information through the commission of a crime also is considered an insider. In the event that a legal entity is liable for inside information violations, the natural persons who are involved in the decision to execute a transaction on behalf of such legal entity are deemed insiders.[197] The following financial instruments are subject to the rules of insider trading and market manipulation:

- Securities as defined under article 1, paragraph 4, of the Securities Supervision Act 2007;
- Shares in entities for joint investments;
- Money market instruments;
- Financial futures contracts, including transacted cash settlements of comparable instruments;
- Forward-rate agreements;
- Equity swaps: interest and foreign exchange swaps and swaps on shares or stock indices;

195 *Telekommunikationsgesetz* 2003, art 107, para 3.
196 Stock Exchange Act, art 48a, para 1, no 1.
197 Stock Exchange Act, art 48b, para 4.

- Call and put options on all instruments set forth above, including parallel instruments settled in cash, such as foreign exchange and interest rate options;
- Commodity derivatives; and
- All other instruments listed on a regulated market in an EEA member state or for which the application has been submitted for listing on such a market.[198]

Additionally, insider trading rules apply to any financial instrument admitted to trading on a regulated market in at least one member state, or for which an application for admission to trading on such a market has been submitted, irrespective of whether or not the transaction itself actually takes place on that market and to any financial instrument not admitted to trading on a regulated market in a member state, but whose value depends on a financial instrument in the aforementioned meaning.[199] Abuse of inside information occurs when a person utilizes inside information with the intention of procuring a financial benefit for oneself or a third party by:

- Purchasing or selling the relevant instruments or proposing or advising to purchase from/sell instruments to a third party or regarding two-day spots on emission allowances, pursuant article 3, number 5, of Regulation (EU) 1031/2010;
- Placing a bid with the intention to profit from the misuse of inside information or advising the action to a third party; or
- Disclosing inside information to a third party absent an obligation or need to do so.[200]

Generally, market manipulation involves transactions or purchase/sell orders, which either send or are likely to send false or deceptive signs concerning the price, supply, or demand for instruments or are executed by one or more persons intentionally acting in concert to drive up the price of one or more financial instruments to a level that is artificial or abnormal.[201] However, if such person has legitimate reasons for this and the transactions or orders are in conformity with the relevant regulated market's accepted market practices, such action may not be deemed as market manipulation.

Release of Inside Information to Public. Issuers having inside information relating directly to their financial instruments are obliged to immediately disclose and disseminate such information and any amendment to the public. The information must be disseminated simultaneously for all categories of investors in the relevant EEA member states. This inside information also must

198 Stock Exchange Act, art 48a, para 1, no 3, lets a–j.
199 Stock Exchange Act, art 48e, paras 2 and 3.
200 Stock Exchange Act, art 48b, para 1, nos 1 and 2.
201 Stock Exchange Act, art 48a, para 1, no 2, let a.

be available for the public on the issuer's website for an appropriate period of time.[202]

The issuer may postpone the release of the inside information, provided that it could be potentially damaging to the issuer's legitimate interests, ie, to prevent disruptions of ongoing negotiations, unless concealing the information would be deceptive for the public and the issuer is not required to ensure the information to remain confidential.[203] The issuers are obliged to guarantee confidentiality of inside information; thus, they must regulate who has access to it. They must take effective and required measures to:

- Prevent unauthorized persons from gaining access to such information;
- Ensure that every person who has access to inside information assents to the legal duties resulting from such knowledge and is informed of the sanctions for abuse and improper dissemination of inside information; and
- Permit immediate release of such information.[204]

Issuer Compliance Resolution 2007. The Issuer Compliance Resolution 2007 (*Emittenten-Compliance-Verordnung*) provides guidelines for the dissemination of information within companies and organizational measures to prevent the abuse of inside information and other compliance-relevant information.

This resolution applies to issuers of shares or securities on the regulated market in Austria pursuant to article 1, paragraph 2, of the Stock Exchange Act. The regulations do not apply to issuers of financial instruments that only trade on multilateral trading systems, municipalities, and international and supranational organizations.[205] For the purposes of this Act, compliance-relevant information is insider information as well as other confidential, price sensitive information that does not meet the criteria of insider information, ie, not made public, qualified to influence the price. Thus, any information a reasonable investor does not think will become insider information in the future is not compliance-relevant.[206]

The issuer has a duty to issue an internal compliance policy and to notify the FMA; thus, confidential areas (*Vertraulichkeitsbereiche*) must be specified. Furthermore, the issuer must produce and maintain an insider list and provide it to the FMA upon request.[207] The compliance policy must include the following:

- Specified confidential areas;
- Implementation of duties with respect to the dealing with inside information;

202 Stock Exchange Act, art 48d, para 1.
203 Stock Exchange Act, art 48d, para 2.
204 Stock Exchange Act, art 48d, para 2, no 2.
205 *Emittenten-Compliance-Verordnung* 2007, ch 1, art 2.
206 *Emittenten-Compliance-Verordnung* 2007, ch 1, art 3, nos 1 and 1a.
207 *Emittenten-Compliance-Verordnung* 2007, art 11, no 1.

- Regulations regarding the transfer of inside information;
- Duration of retention periods prior to the planned publishing of figures;
- Transfer of director's dealing reports;
- Insider register;
- Rights and duties of the compliance department; and
- Consequences of a violation of the compliance policy under civil and labor law.[208]

Records of Insiders. The issuers or any person acting on their behalf or for their account must keep a record of the persons who work for them with a regular, or on an *ad hoc* basis, access to inside information. This record must be updated regularly and be forwarded to the FMA on request.[209] This insider list must include the following:

- Compilation and updated data of the insider lists;
- Declarations of natural persons of confidential groups certifying, to the best of the issuer's knowledge, their first and last name, date of birth, address, and membership of the groups;
- Declaration by the legal representatives of the confidential groups certifying, to the best of the issuer's knowledge, their business relationship with the person of such groups and that person's membership of groups, and his company register number noted at the beginning and end of such document; and
- All other required information pursuant to article 6, paragraph 4, and article 8, paragraph 5, of the Resolution.[210]

The provisions regarding the release of inside information and the records of insiders are not applicable to issuers who have not applied for admission of their financial instruments to be listed on a regulated market in an EEA member state or such admission has not been granted.[211]

Reporting Duties. Persons who either have close ties with issuers and persons who have a management position with an issuer of financial instruments with its registered office in Austria or the obligation to submit annual documents pursuant to article 10 of Directive 2003/71/EC must report all of their trading in equities and equity-like securities admitted to the regulated markets of the issuer or any related trades in derivatives or associated companies to the FMA.

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208 *Emittenten-Compliance-Verordnung* 2007, ch 1, art 12, paras 1 and 2, nos 1-8.
209 Stock Exchange Act, art 48d, para 3.
210 *Emittenten-Compliance-Verordnung* 2007, ch 1, art 11, para 2, nos 1–4.
211 Stock Exchange Act, art 48e, para 4.

The report must be made within five working days after the execution date of trade, but may be extended until the total volume of the trade executed reaches €5,000. This report may be omitted if the total volume of the trade executed fails to reach the amount by the close of the calendar year.[212] Furthermore, persons having their registered office or branch office in Austria who are professionally engaged in trading of securities must immediately inform the FMA of any well-founded suspicion they may have with regard to a transaction that could be an inside deal or constitute market manipulation.[213]

The above-mentioned prohibitions and requirements apply to actions which are executed in Austria or abroad concerning financial instruments that are admitted to trading on a regulated market situated or operating in Austria or for which an application for admission to trading on such a market has been made, or actions which are carried out in Austria concerning financial instruments that are admitted to trading on a regulated market in a member state or for which an application for admission to trading on such market has been made.[214]

Recommendations. For the purposes of the Stock Exchange Act, a recommendation is defined as:

'…an analysis or other explicit or implicit information, intended for information dissemination channels or for the public, recommending or suggesting an investment strategy regarding one or more financial instruments or issuers of financial instruments, including an assessment of the value or price of such instruments.'[215]

The issuer of a recommendation is obliged to:

- Specify the identity of the issuer and the legal entity who is responsible for its preparation;
- Specify the identity of the competent authority if the relevant entity is a securities firm or credit institution;
- Refer to the standard and rules mentioned if the issuer is neither a securities firm nor a credit institution; and
- In the case of non-written recommendations, specify where the information mentioned above is available to the public.[216]

A recommendation must contain detailed information as set forth in article 48f of the Stock Exchange Act, ie, reference to all essential sources, basis for the valuation, used methods, warning of potential risks, and conflicts of interest.[217]

212 Stock Exchange Act, art 48d, para 4.
213 Stock Exchange Act, art 48d, para 9.
214 Stock Exchange Act, art 48e, para 5, nos 1 and 2.
215 Stock Exchange Act, quoting article 48f, paragraph 1, number 3.
216 Stock Exchange Act, quoting article 48f, paragraph 2, numbers 2–4.

Penal Provisions for Insider Trading. A person who abuses inside information must be punished by law by a prison sentence of up to three years and, if the benefit gained exceeds €50,000, by a prison sentence of six months to five years.[218]

A person who is not an insider and takes advantage of inside information that he is informed of or learns of in any other manner with the intention to gain a pecuniary benefit for himself or herself or a third party must be punished by law to a prison sentence of not more than one year or to a fine of not more than 360 times the daily fine rate as set by the court, but if the pecuniary benefit gained exceeds €50,000, the punishment must be a prison sentence of up to three years.[219]

Penal Provisions for Market Manipulation. Any person engaged in market manipulation — unless the act is a criminal offense punishable under the jurisdiction of the courts — must be deemed to commit an infraction of administrative law and must be punishable by the FMA by a fine of up to €150,000. The Administrative Offenses Act must apply. Any attempt also is punishable by law. Any pecuniary benefit gained from such acts must be declared void by the FMA.[220]

Member States. The provisions regarding abuse of inside information and market manipulation do not apply to trading in own shares in the form of 'buy-back' programs or price stabilization measures provided such transactions are carried out in accordance with Commission Regulation 2273/2003/EC.[221]

Traders, Trading Rules, and Trading Systems

Traders

Pursuant to article 32 of the Stock Exchange Act, official brokers (*Sensale*) are the officially appointed self-employed intermediaries of the exchange.[222] If the conclusion of dealings is not executed exclusively by the automated trading system, the FMA must appoint an adequate number of official brokers.[223] Prior to appointments, a public announcement of the vacant official broker position must be published in the *Official Gazette* of the *Wiener Zeitung* and in the organ of the exchange.

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217 Stock Exchange Act, art 48f, para 4, nos 1–6.
218 Stock Exchange Act, art 48b, para 1.
219 Stock Exchange Act, art 48b, para 2.
220 Stock Exchange Act, art 48c.
221 Stock Exchange Act, art 48e, para 6.
222 Stock Exchange Act, art 32, para 1.
223 Stock Exchange Act, art 32, para 2.

All appointments require the approval of the state governor (*Landeshauptmann*).[224] Official brokers may be appointed in general for all types (pursuant to article 35, paragraph 1) or for specific types of intermediary dealings. The FMA must issue the official broker an appointment decree, which identifies the appointed exchange and the scope of such appointment. Subsequent to an appointment, the appointed exchange's competent Chamber of Commerce and Industries must be informed. In addition, the appointment must be announced in the *Official Gazette* of the *Wiener Zeitung* and in the organ of the Stock Exchange. The Stock Exchange Act provides that in order to become an official broker, a person must:

- Be at least 24 years of age;
- Have full legal capacity;
- Have successfully passed the official broker examination; and
- If the official broker is appointed for the securities exchange *(Wertpapierbörse)*, have at least three years of experience in the field as an official broker's assistant or as an employee of a non-official broker; or
- If the official broker is appointed for the commodity exchange *(Warenbörse)*, have at least five years of professional experience in a relevant line of business or be a judicially certified expert for such industry.[225]

Official brokers are granted various rights, such as the right to mediate contracts for negotiable instruments, as well as for the admissible auxiliary transactions concluded on the exchange.[226] Additionally, official brokers are entitled to a brokerage (broker's fee) for such completed transactions.[227] However, they are not permitted to mediate such deals in securities during stock exchange trading hours, unless the securities are quoted on the Official List of the Official Market of the Exchange. Furthermore, exchange brokers for the Commodity Exchange are entitled to render expert opinions as standard practice in their industry.[228]

Although official brokers enjoy various rights and duties, ie, the right and duty to fix the official exchange price, there are some restrictions that apply.[229] Official brokers must be present on the exchange during the entire trading period to keep records, or must provide written notice to the Exchange Commissioner and the Stock Exchange who must act as the official broker's representative.[230] Official brokers are under a duty to execute the transactions entrusted to them

224 Stock Exchange Act, art 32, para 3.
225 Stock Exchange Act, art 33, para 1, nos 3a and b.
226 Stock Exchange Act, art 35, para 1.
227 Stock Exchange Act, art 39, para 1.
228 Stock Exchange Act, art 35, para 1.
229 Stock Exchange Act, art 36.
230 Stock Exchange Act, art 37.

with the proper care of registered commercial businesspersons. They must avoid any activities which may damage their integrity in regards to their impartiality, the credibility of the prices they determine, or the certificates they issue.[231]

The official broker's activities must be 'supervised by the Stock Exchange, which in particular has the right to look into all the books of the broker for this purpose'.[232] Official brokers are appointed for an indefinite period of time. Upon request of the Stock Exchange, the FMA must remove the official broker for various reasons. Some examples include, but are not limited to, when he commits certain offences or when he has reached the age of 65 at the end of the year.[233]

The allotment of the negotiable instruments to the individual non-official brokers (*freier Makler*) must be done by the Stock Exchange with their agreement, and may be revoked at any time after hearing the representatives of the interest group of the non-official brokers if there is such a representative on the exchange concerned.[234] Furthermore, the Stock Exchange must appoint a non-official broker from among its members, if required to do so under article 56, paragraph 1; such appointees must act as intermediaries for the purpose of article 56, paragraph 4.[235] Additionally, if admitted by the Stock Exchange, the non-official brokers must be authorized to conduct the banking activities in accordance with article 1, paragraph 1, number 7, of the Banking Act with either other credit institutions licensed to perform the activities, as referred to in article 2, paragraph 23, of the Banking Act or investment firms pursuant to article 4, paragraph 1, of Council Directive 2004/39/EC. Non-official brokers may not engage in banking conduct beyond this scope; hence, they cannot officially fix exchange prices.[236]

The right to trade on the exchange must be obtained through entering an agreement with the Stock Exchange. Provided the applicant satisfies all the legal requirements, the Stock Exchange will be held under obligation to contract. Traders are physical persons who have been admitted as traders to the exchange by the Stock Exchange, and are authorized to place orders and to close dealings on behalf of members on the exchange or within the trading system.[237] To be admitted as a trader to the exchange, the applicant must fulfill the following conditions:

- The person must be a physical person and a member of the exchange;
- The person must either belong to the management of a member; or

231 Stock Exchange Act, art 36.
232 Stock Exchange Act, art 42.
233 Stock Exchange Act, art 43.
234 Stock Exchange Act, art 56, para 4.
235 Stock Exchange Act, art 57, para 1.
236 Stock Exchange Act, art 57, para 2.
237 Stock Exchange Act, art 20, para 1.

- The person must be employed by the management of one of the members.[238]

Furthermore, they must meet the requirements provided in article 14 of the Stock Exchange Act (see text, above). Note, admission grounded in the first and third items, above, requires that the person have adequate experience and qualifications to participate in Stock Exchange trading, so that he will not disrupt trading.[239]

Trading Rules

Austrian law does not provide many specific rules for the offering of securities to the public except the obligation of the offeror of listed, as well as unlisted, securities to publish a prospectus at least one day before the offering begins. According to the Capital Market Act, this prospectus must be examined and signed by one of the credit institutions or associations referenced in article 8, paragraph 2, of the Capital Market Act.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties. A person who intends to directly or indirectly possess a qualified share in a stock exchange is required to inform the FMA where general commodity exchanges are involved. This notification must be transcribed identifying the amount of the stake and submitted prior to acquisition of the shares.

Furthermore, any person determined to gain more volume in a qualified share in a stock exchange to an amount that will result in reaching or surpassing the limits of 20 per cent, 33 per cent, or 50 per cent of the voting rights or the company's capital, or where the relevant company becomes a subsidiary of the person, must submit written notice to the FMA prior to the procurement. When general commodity exchanges are involved, such notice must be delivered to the Federal Ministry of Economics and Labor (*Bundesministerium für Wirtschaft, Forschung und Wissenschaft*) prior to acquisition. The shareholder is required to submit written notification of any acquisition or divestiture of shares resulting in stakes falling below or surpassing the shareholding allowance, to the relative competent body.[240]

Persons who, directly or indirectly, acquire or sell holdings in a stock corporation admitted to trading on a regulated market are obliged to immediately, but at the latest within two business days of the relevant event, inform the FMA, the shares' issuer, and the Stock Exchange, about the voting rights held following the completed transaction, if as a result their proportion of voting rights held reaches, exceeds, or drops below four per cent, five per cent,

238 Stock Exchange Act, art 20, para 2.
239 Stock Exchange Act, art 20, para 3.
240 Stock Exchange Act, art 6.

10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 35 per cent, 40 per cent, 45 per cent, 50 per cent, 75 per cent, and 90 per cent.[241]

The obligations stated above must apply only with respect to issuers for which Austria is the home member state and *vis-à-vis* the exchange operating company only if the securities of the issuer have been admitted to listing on a regulated market of the exchange operating company. The period of two trading days runs as of the day following the day on which the person gains knowledge of the relevant transaction or on which the person should have gained knowledge of the circumstances, regardless of the actual date of such transaction or when the power to exercise such voting rights are realized, or has been notified of the calculated percentages of the voting rights.[242] This requirement does not apply if the acquisition or sale is effected in the course of securities dealings business conducted by credit institutions and other investment services providers.[243]

Company Duties. Once the issuer receives official notice that there is a considerable change in the proportions of voting rights in a stock corporation, in respect to figures previously published, such issuer is required to immediately, but at the latest within two business days from the receipt of notice, disclose all the information included in the notification.[244]

If the shares also are quoted on a foreign exchange, at least such information must be published as is given to the public in the country where this foreign exchange is located. If the company fails to publish such information, the FMA must make it public at the expense of the company.

Supervisory Power of the FMA. The FMA is responsible for supervising compliance with the relevant provisions set forth in article 48a–f of the Stock Exchange Act.[245] For this purpose, the FMA has certain rights, ie, conduct investigations, inspect the results of telecommunication surveillance, order the Stock Exchange to suspend trading in a financial instrument, and issue a ban on accused persons from exercising their profession, in addition to the authority to impose fines.[246]

Every year, the FMA must send to ESMA a summary of the information on all administrative measures taken and on all sanctions imposed. When the FMA announces administrative measures or a sanction to the public, it must

241 Stock Exchange Act, art 91, para 1; applicable to the thresholds designated by the issuer in its by-laws in compliance with article 27, paragraph 1, number 1, of the Takeover Act, *Federal Law Gazette* I Number 127/1998.
242 Stock Exchange Act, art 91, para 1.
243 Stock Exchange Act, art 91, para 2a.
244 Stock Exchange Act, art 93, para 2.
245 Stock Exchange Act, art 45 (Supervision of the Exchange), para 1.
246 Stock Exchange Act, art 48q (Supervisory Powers of the FMA), paras 1–5.

simultaneously inform ESMA.[247] Due to the international financial markets crisis and its impact on domestic regulated markets, Austria has devised a comprehensive and sustainable package of measures for the protection of savings account holders and the strengthening of banks (eg, the IBSG).

The central aspects of the Austrian package address the need for liquidity in the financial sector, set the groundwork for a possible measure to strengthen the equity of banks, provide retroactive safeguards on an individual's deposit from 1 October 2008, and include a rule of the speculative short selling of securities.

Speculative Short Selling of Securities. According to articles 5 to 10 of Regulation 236/2012 of the European Parliament and the Council of 14 March 2012 on short selling and certain aspects of Credit Default Swaps (SSR), significant net short positions on shares, sovereign debts, and uncovered positions in sovereign Credit Default Swaps (CDS) must be reported to the relevant competent authority.

Trading Systems

Electronic Trading Systems. Electronic trading systems are only available to Stock Exchange members. The two trading systems used in Austria are:

- Xetra® for cash market securities; and
- Eurex® for derivatives.

Xetra® (Exchange Electronic Trading) is the electronic trading system of the *Deutsche Börse*, which was introduced to the Austrian exchange in November 1999. Xetra® provides various services, such as trading periods with only one auction, continuous trading with numerous auctions, and a continuous auction. During the trading procedure known as an auction, there is a specific time at which the liquidity available in a security is concentrated.[248] Auction schedules are published, so that market participants may know when specific securities will be called. Auctions are comprised of three phases:

- The call phase (*Aufrufphase*);
- The price determination phase (*Preisermittlungsphase*); and
- The order book balancing phase (*Marktausgleichsphase*).[249]

The order book is opened during the call phase of stocks being traded, at which time a preliminary, tentative price is quoted (price determination phase). Auction prices are fixed by determining the price that will actualize the largest

247 Stock Exchange Act, art 48q, para 6.
248 See http://en.wienerborse.at/marketplace_products/trading/tradingsystems/xetra.html.
249 See http://en.wienerborse.at/marketplace_products/trading/tradingsystems/xetra.html.

volume of orders, while minimizing the amount of orders left unfilled. Orders which cannot be traded in the price determination phase are offered in the order book balancing phase.

Continuous trading begins immediately after the opening auction is closed. The electronic order book juxtaposes the purchase and sale orders. This order book and display remain open during continuous trading, thus allowing market participants to view aggregate purchase orders adjacent from applicable limits. Once the limit is reached, the orders are automatically processed. This type of trading procedure offers benefits, such as closing trades without waiting for an auction and a guarantee from the firm that quotes are continuously entered into the system; continuous input of quotes increases liquidity of the market. Continuous trading has the following types of orders:

- Limit order;
- Market order;
- Stop order (stop market order and stop limit order);
- 'Iceberg' order (minimum overall quantity of 1,000 and minimum peak quantity of 100); and
- Market-to-limit order.[250]

Continuous auctions transpire throughout the trading day, comprising of three phases: the pre-trading phase, the main trading phase, and the post-trading phase. The end of one phase automatically triggers the beginning of the next. An auction has two phases, the pre-call or an optional call phase and the price determination phase. Prior to the start of the price determination phase, all market participants may continue to enter, change, or delete orders; exchange members acting as liquidity providers; or may enter or delete quotas during this time. The available types of orders are the limit orders, market orders, and stop orders. These orders are subject to order restrictions.

On 26 April 2010, the Eurex® trading system replaced OMex®. Eurex® is used to trade derivative products (financial futures contracts and options). Trading is executed exclusively through continuous trading, which begins with the pre-opening phase. During the first phase, orders and quotes may be entered, modified, or deleted. The system uses this information along with the information entered from the previous day to determine an opening price. The next phase is the price determination, called netting, which only takes seconds.

There is only one determined price each trading session. Immediately following netting, the continuous trading begins. The order book remains open in this phase and, as each order is placed, the system automatically checks to see if it

250 Various restrictions may be placed on orders.

can be filled against existing orders.[251] All trading through this system is anonymous, even after the trade is confirmed. The orders are filled according to a price and time priority. In contrast to Xetra®, all order sizes can be placed through Eurex®. The following types of orders are available:

- Limit order;
- Market order;
- Stop order (only for futures); and
- One-cancel-the-other-order (only for futures).[252]

Off-Market Transactions. Off-market transactions can be carried out by Stock Exchange members, ie, between credit institutions. Even the securities listed on the official or unlisted securities market may be traded off the floor. Exchange members do not have the duty to trade listed securities exclusively on the stock market.

Additionally, credit institutions have the possibility to adjust buy-and-sell offers sent to them by different clients themselves, or to sell their own securities to a bidder-client. Nevertheless, such off-floor trades must be reported to the Stock Exchange by the exchange members on every exchange trading day.[253]

Members who deal in officially listed securities off the exchange also must publish these turnovers in an official bulletin, unless bonds and other forms of secured debt, block transactions, or highly illiquid instruments are concerned. For the purpose of insider dealing investigations, off-floor trades also must be reported according to article 64, paragraph 1, of the Securities Supervision Act 2007.

Jurisdictional Conflicts

In General

Although jurisdictional conflicts are likely to occur in the global securities business, effective multilateral solutions are often lacking. The EU and the EEA have established systems of procedural management of jurisdictional conflicts, as well as substantive law solutions.

An increasing number of EU Directives and Regulations will ensure the harmonization of national regulations and help to avoid international

251 See http://en.wienerborse.at/static/cms/sites/wbag/media/en/pdf/marketplace_products/derivatives_market_marktmodell.pdf.
252 See http://en.wienerborse.at/marketplace_products/trading/tradingsystems/.
253 Stock Exchange Act, art 65.

delinquency in securities business. Austrian law lays down specific rules for jurisdictional conflicts concerning contracts in general in the Rome I Regulation,[254] which replaced (together with the Rome II Regulation[255]) the Rome Convention of 1980 in the year 2009, as well as transactions concluded at stock exchanges in the International Private Law Act (*Internationales Privatrechts-Gesetz*, IPRG).

Multilateral Approaches

Substantive Law Solutions

The Rome Convention of 1980, which was signed by all members of the EU, provided for solutions of jurisdictional conflicts for contract law in general, but obligations resulting from the negotiable character of instruments were not included. The Rome Convention stated the freedom of the contracting parties to choose the law governing their contractual relationship or single aspects of the contract.

As mentioned above, the Rome Convention was replaced by two Regulations: the Rome I Regulation, effective as of 17 December 2009, and the Rome II Regulation, effective as of 11 January 2009. The Rome I Regulation stipulates the law applicable on contractual obligations arising from all contracts with EU member states, with the exception of Denmark, concluded after 17 December 2009.

Concerning all contracts concluded before this date, the Rome Convention of 1980 is still applicable. According to the Rome I Convention, the contractual parties are still free to choose the applicable law with an exception regarding the facts which are only domestic (*Inlandssachverhalte*).

Regarding those facts, the contractual parties may not choose a foreign law in order to avoid obligatory domestic provisions. The Rome II Regulation stipulates the law applicable to non-contractual obligations, such as unjust enrichment (*ungerechtfertigte Bereicherung*), *culpa in contrahendo* (*Verschuldens bei Vertragsverhandlungen*), and unfair competition (*unlauterer Wettbewerb*).

Procedural Solutions

In 2002, the Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (EUGVVO)[256] came into effect and replaced the Brussels Convention on the recognition and

254 Regulation (EC) 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

255 Regulation (EC) 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II).

256 Council Regulation (EC) 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

enforcement of judgments (except for Denmark, which entered into force on 1 July 2007). The EFTA States signed the nearly identical Lugano Convention (convention on jurisdiction and the enforcement of judgments in civil and commercial matters) so that, in effect, there is one regulatory system for all EU and EFTA member states.

According to the regulations, parties have the freedom to submit to a jurisdiction of their choice (in cases of non-exclusive jurisdiction). If the submission agreement between the parties has not been expressed clearly or if such an agreement does not exist, the general rules apply. A person must be sued in his country of residence and legal entities must be sued in the country of their registered office. A party to a contract also may be sued in the country that is determined to be the place of performance. The Council Regulation and the two conventions state a number of detailed provisions for the determination of the jurisdiction in special cases, but securities transactions are not specifically mentioned.

In procedures concerning the validity of the constitution, dissolution of a company, or decisions of the administrative organs, the country where the company has its registered office has exclusive jurisdiction. If the validity of entries in official books or registers is concerned, the exclusive jurisdiction is conferred to the country where the books or registers are kept. Proceedings regarding the enforcement of judgments always must be conducted at the courts of the state where the judgment concerned was made.

Unilateral Approaches

The IPRG regulates the determination of the governing law in Austria. In general, parties are free to agree on the law of any country as governing law if the application of that law by Austrian courts does not violate the public order. When there is no such agreement, contracts are governed by the law of the country where the party whose performance is non-monetary resides or has its registered office.

In the case of contracts that create duties for only one party, ie, donations, the law of that country applies where the obliged party resides or has its registered office. Banking contracts are governed by the law of the country where the credit institution has its registered office. If both of the parties are credit institutions, the law of the country where the instructed credit institution is seated applies. Transactions concluded on a stock exchange or on a market are governed by the law of the country where the stock exchange or the market is situated.

Special Rules

Investment Fund Act

The FMA must inform customers of management companies or UCITS who complain of a breach by a management company or by a UCITS of articles

10–35 or of a provision of chapters 3 or 4 of the InvFG of the possibility of filing a complaint with the out-of-court Conciliation Board FIN-NET (article 3, number 9, of the Payment Services Act (*Zahlungsdienstegesetz*)) and indicate the registered office and address thereof.[257]

257 Investment Fund Act, art 193, para 4.

Belgium

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Belgium

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Institutional Framework and Organisation of Regulated Markets

Legal Framework

The Law of 6 April 1995 on Secondary Markets, the Status and Supervision of Investment Firms, Intermediaries, and Advisers implemented the European Community (EC) Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (the 'Investment Services Directive') and the EC Directive on the capital adequacy of investment firms and credit institutions (the 'Capital Adequacy Directive'). The Law of 6 April 1995 amended the Law of 4 December 1990 on Financial Transactions and Financial Markets, which itself constituted a general overhaul of the legal framework of Belgian securities legislation. The Law of 6 April 1995 implemented the EC Directives and restructured Belgian financial markets to enhance their competitiveness with other European markets. Two important new concepts were introduced into Belgian law, namely:

- The concept of 'financial instrument'; and
- The notion of 'regulated market'.[1]

In general, financial instruments can be traded on a stock exchange or another financial market, and they can enter into the scope of the so-called 'European passport' (mutual recognition). However, not all instruments can effectively be traded on a stock exchange. Instruments that naturally cannot be traded on an exchange include over-the-counter instruments such as swaps and forward-rate agreements. Categories of financial instruments which are already listed on a stock exchange may only be traded on another stock exchange or financial market with the approval of the body responsible for the management of the market on which the financial instrument is already traded (eg, options traded

1 Law of 6 April 1995, art 1.

on Belfox will not be listed on the Brussels Stock Exchange). The following instruments are considered financial instruments:

- Shares, bonds, warrants, and inscription rights;
- Participations in collective investment undertakings;
- Money market instruments (eg, treasury bills, commercial paper, and *billets de trésorerie*);
- Financial futures contracts, including equivalent cash-settled instruments;
- Forward interest rate agreements;
- Interest rate, currency, and equity swaps; and
- Options to acquire or dispose of any instruments mentioned above, including equivalent cash-settled instruments and options on currency and on interest rates.

This list is clearly based on section B of the Annex to the Investment Services Directive. However, the general notion of 'transferable securities' is not being adopted. As the notion of 'securities' is frequently used in Belgian company and financial law (eg, in the take-over legislation), the omission of this notion in a general definition is to be regretted. A regulated Belgian market is a market of financial instruments which functions regularly, whose organisation and operation is regulated, and which appears on the list of regulated markets established by the Belgian Minister of Finance. This list is published and communicated to the other European Union (EU) member states and to the European Commission. The Ministerial Decree of 3 May 1996, as amended, provides a list of the regulated Belgian markets, as of 31 December 1997, namely:

- The first market, the secondary market, and the EURO.NM market of the Brussels Stock Exchange;
- The Belgian futures and options market, known as Belfox;
- The secondary off-market of public debt instruments; and
- The European Association of Securities Dealers Automated Quotation, known as Belfox.

This notion is based on article 1.13 of the Investment Services Directive. Article 7 of the Law of 6 April 1995 defines a stock exchange (*bourse de valeurs mobilières*) as a market where transactions are public and where anyone who so desires may, through an intermediary authorised to act at the exchange, buy or sell financial instruments admitted to that market. The first market of the Brussels Stock Exchange is itself subdivided into different sections according to the nature of the market and instruments traded on the market and the liquidity of the market. In the forward section, transactions are settled every two weeks (*quinzaine*). This market is specialised in large companies. On the spot market, which is specialised in small and medium-sized companies, settlements take place three days after the transaction. In the public debt instruments section, public debt instruments are traded which have been issued by the Belgian state, regional authorities, their subdivisions or other public authorities.

Legal Form, Shareholding, and Membership in the Brussels Stock Exchange

Legal Form

The Brussels Stock Exchange is organised by the Stock Exchange Corporation of Brussels, which is a co-operative corporation with limited liability.[2] This company, like any other company, is governed by the Consolidated Laws on Commercial Companies. It also is governed by its articles of association and the Law of 6 April 1995 to such an extent that the latter provisions will prevail over the 'general' rules of the Consolidated Laws on Commercial Companies.

The Brussels Stock Exchange has a somewhat hybrid form. An example of this is the distinction between shareholder and member. It is a commercial company, subject to the rules of company law and, therefore, has corporate bodies, internal operational rules as a company, and articles of association. At the same time, it is a regulated market in which members have access to the market and, as such, it is legally organised by the regulations of the Brussels Stock Exchange approved by the Royal Decree of 16 February 1996 and the market regulations of the Brussels Stock Exchange approved by the Ministerial Decree of 16 April 1996. The effects of this hybrid organisation of the Brussels Stock Exchange will be felt throughout the operation and control of the Brussels Stock Exchange as, for example, in the respective roles of the Board of Directors and the Management Committee.

It is expected that the Brussels Stock Exchange will merge with the Belgian options and futures market BELFOX and with the *Interprofessionele Effectendeposito- en Girokas NV/Caisse Interprofessionnelle de Dépôts et de Virements de Titres SA*, known as the CIK. The CIK is the central depository in Belgium for fungible securities that can be given in custody with the CIK and traded by book entries on accounts of affiliates held in the books of the CIK. In the future, the CIK also will do the clearing of all dematerialised and fungible securities issued by private (as opposed to public or state-related) issuers.

Shareholders and Members of the Stock Exchange Corporation

Before 1 January 1996, the date on which the largest part of the Law of 6 April 1995 entered into force, only stock brokerage firms could become members of the Brussels Stock Exchange. In addition, no distinction was made between the status of membership in the Stock Exchange and the status of shareholder. Under the Law of 6 April 1995, a distinction was made between the status of member and the status of shareholder. To be able to do their business, stockbrokerage firms are still compelled to become shareholders in the Stock Exchange Corporation. This also is applies to other investment firms which are licensed to carry out transactions in financial instruments for their own account or for the account of certain categories of clients.

Financial institutions can become full shareholders of the Stock Exchange Corporation as well as becoming members of the Exchange. This is new as, before 1996, they had no

2 Law of 6 April 1995, art 9.

direct access to the exchange. As a consequence of this rule, all major Belgian credit institutions owned and controlled a stockbrokerage firm to gain access, however indirect, to the Stock Exchange. The membership of the markets or market sections is now open to:

- Licensed Belgian or European Union investment firms;
- Licensed branches of third-country investment firms;
- Belgian and European Union credit institutions (licensed to carry out transactions in financial instruments for their own account or for the account of certain categories of clients); and
- Branches of third-country credit institutions.

In theory, shareholding and membership of the Stock Exchange should be two different things. However, the regulations of the Brussels Stock Exchange, approved by the Royal Decree of 16 February 1996, provide that, to become a member of the Stock Exchange, Belgian credit institutions must become shareholders of the Stock Exchange Corporation. This enables the Stock Exchange to gain a sufficient capital base. This rule is not applicable to foreign, non-Belgian members.[3] However, only foreign institutions from European Union member states can become members of the Stock Exchange on the basis of a remote membership. Financial intermediaries of other states must be established in Belgium to become a member. This rule is justified on the basis of the difficulty of controlling these institutions as, for these institutions, the home-country-control rule is not relevant.

To avoid conflicts of interest, companies whose securities are listed on one of the market sections of the Brussels Stock Exchange may not become shareholders of the Stock Exchange Corporation. The admission of new shareholders and the revocation and resignation of existing shareholders is decided by the Board of Directors.

Corporate Bodies of the Stock Exchange

The powers of the general meeting of the Stock Exchange Corporation are the traditional powers of a general meeting in a commercial company. These powers are laid down in the Consolidated Laws on Commercial Companies and the articles of association of the Corporation. However, these powers have become somewhat eroded since the president and vice-president of the Stock Exchange are nominated by the King;[4] No shareholder may vote in the general meeting for more than 10 per cent of the total voting rights, even if his shareholding in the Stock Exchange Corporation is greater than 10 per cent.

The general policy of the Brussels Stock Exchange is determined by the Board of Directors (previously known as the Stock Exchange Commission, or *Commission de la Bourse*). The Board of Directors also controls the Management Committee within the framework of the general policy and budget. In addition, it determines the annual

3 Stock Exchange Regulations, art 88.

4 Law of 6 April 1995, art 14; in Belgian company law, it is a traditional privilege of the general meeting to nominate the directors of a commercial company.

contribution of the members (traditionally a prerogative of the general meeting of the Stock Exchange), and it proposes amendments to the articles of association of the Corporation as well as giving advice to the company (although, in matters for which the Management Committee is responsible in its capacity as market authority, the opinion of the Management Committee also is taken into account). The mission of the Board of Directors also includes proposing to the Minister of Finance the appointment or dismissal of the members of the Management Committee.

The Management Committee is responsible for the general management of the Stock Exchange Corporation within the framework of the general policy and budget determined by the Board of Directors and the delegations made by the Board of Directors. At the same time, and totally independent of its more general functions, it acts as a (new) market authority which is independent of the Stock Exchange Corporation. In this capacity it is responsible for the organisation of the Brussels Stock Exchange and the monitoring of the different markets. As such, the Management Committee is responsible, for example, for:

- The acceptation, suspension, and cancellation of financial instruments to the listing;[5]
- The admission of new members to the Brussels Stock Exchange;[6] and
- The revocation of membership.

It also is responsible for the organisation of a clearing and settlement system for transactions concluded on or outside the markets of the Stock Exchange in respect of financial instruments listed on a market of the Stock Exchange.[7] The monitoring of the markets also includes the publication of daily information on transactions and volumes executed on the market. In its capacity as autonomous market authority, the Management Committee is an administrative authority with independent controlling and investigation powers.

Supervision and Control of the Brussels Stock Exchange

Management Committee

In addition to its responsibilities relating to market organisation and the monitoring of the market (as described above), in its role as autonomous market authority, the Management Committee is responsible for the first-line control of the market. Here, the Management Committee has extensive supervisory, monitoring, and investigative powers in relation to the members of the Stock Exchange.[8] The Management Committee monitors the integrity of the market, the transparency of the information, and the compulsory disclosure of occasional sensitive information. The Management Committee also is charged with monitoring and ensuring that the financial intermediaries active on the market respect the rules of the market and the Law of 6 April 1995. It also monitors compliance with the rules on insider trading.

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5 Law of 6 April 1995, art 17.
6 Law of 6 April 1995, art 17; Stock Exchange Regulations, arts 54 *et seq*.
7 This responsibility has been delegated to the Settlement Co-operative (*Coopérative de Liquidation des Marchés*).
8 Law of 6 April 1995, arts 20 and 21.

As stated above, the Management Committee has extensive supervisory, monitoring, and investigative powers. According to article 20 of the Law of 6 April 1995, the Management Committee may gain access to all documents and copy all documents they consider relevant for the investigation. It has the right to obtain any relevant information and can question any officer or employee of a financial intermediary (member of the exchange). The market authority may ask any question that, in its opinion, is reasonable and useful; it has the right to require all information and/or records to be supplied; and it may visit the financial intermediary member of the Stock Exchange, where it has full access to all documents and records. It may consult with other market authorities and exchange information. It may adopt measures of intervention to halt those activities that go against the rules of the Exchange. The relevant market authority has the same powers over foreign member institutions active on the market as it has over Belgian members. The question whether Belgian law applies or not depends on the relevant regulated market (whether a Belgian-regulated market or not).

The Management Committee can order the financial intermediary to immediately halt certain practices which go against the regulations of the exchange, for example, when such practices falsify the functioning of the market, thus giving unfair advantage to those involved, jeopardising the equal treatment of the investors and of the information which must be disclosed to shareholders and investors, and giving an advantage to issuers or investors by manipulations or other practices which are contrary to their professional obligations.

The Management Committee can take disciplinary sanctions against members of the exchange who do not co-operate in an investigation or with the Management Committee. These disciplinary sanctions can range from a warning or reprimand to the suspension of a member for a maximum period of six months from one or more markets on which it is active, and it can go so far as the revocation of the member from one or more markets on which it is active. Administrative sanctions (fines) also are possible.

Banking and Finance Commission

The Banking and Finance Commission (*Commissie voor Bank — en Financierveren / Commission Bancaire et Financière*) is responsible for the second-line supervision of the regulated markets. With respect to the Brussels Stock Exchange, this supervisory duty comprises supervising the administrative organisation of the Board of Directors and the Management Committee, monitoring the procedures necessary for these entities to carry out their tasks, and supervising the manner in which the procedures are complied with.

One important task of this second-line supervisory body is supervising the manner in which the Management Committee carries out its duty as market authority. If the Banking and Finance Commission is of the opinion that the Board of Directors or the Managing Board are not fulfilling their duties in a satisfactory manner, it has the option of setting a time period within which the situation must be rectified. If the situation is not rectified within the given time, the case may be submitted to the Ministry of Finance.

Ministry of Finance

The Ministry of Finance is the controller of last resort. The Ministry of Finance may take any measures it considers necessary to remedy the situation, including recommendations on the situation, suspension of the decisions, and the dismissal of defaulting members of the Management Committee.[9]

Commission of Appeal

An appeal may be lodged against any decision of the Management Committee with the Commission of Appeal.

Belgian Offering and Listing Regulations

Application of Belgian Law

Irrespective of its nationality, any company requiring a listing on a Belgian official exchange or making a public offering in Belgium must adhere to the Belgian listing requirements or the Belgian local offering laws, respectively. A quotation on EASDAQ and EURO.NM Belgium is not an admission to the official listing of a stock exchange but is rather based on the concept of a public offering of securities. Likewise, such admission to trading will not trigger the application of listing regulations but instead the application of public offering laws.[10]

Belgian Public Offering Laws

In General

Public offerings of securities in Belgium are regulated under Belgian law and supervised by the Banking and Finance Commission.

Issue of Securities

The core of the Belgian legislation lies in articles 26 *et seq* of Royal Decree Number 185 of 9 July 1935. The Banking and Finance Commission adheres to a broad interpretation as to what operations fall within the scope of this Decree. Any public offering of securities, public issue, or exchange, and any listing on a Belgian official exchange or other public market falls within the scope of application of the Decree. Judicial public sales or public sales ordered by Stock Exchange Authorities are excluded.

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9 Law of 6 April 1995, art 5.

10 It also will have an impact on the type of prospectus that must be established in case of admission of securities to trading on EASDAQ or EURO.NM.

Offer in Belgium

The offer (or issue or exchange) must take place within Belgium. This is a factual circumstance. The nationality both of offeror and of recipient are irrelevant for this criterion. What is relevant is the question as to whether the offer has been made on Belgian territory. It goes without saying that (public) offers through new media such as the Internet pose considerable problems with respect to this criterion.

When an offer is made simultaneously in Belgium and abroad, the issuer must take the different national legislation into consideration. Under certain circumstances, a prospectus made in Belgium by application of the relevant Belgian regulation can benefit from a mutual recognition in another EU member state.

Public Character of Offer

The most important question in relation to the scope of application of Royal Decree Number 185 is the question as to the public character of the offer. The public character of the offer of securities will be determined by the Royal Decree of 9 January 1991 on the public character of transactions involving public appeal to savings and the qualification of certain operations as public offerings. According to this regulation, an offer is public:

- When use is made of any means of publicity or advertising of whatever nature aimed at the public in Belgium to announce or recommend the offering;[11]
- When one relies on a professional intermediary in Belgium, or when such a professional intermediary intervenes in the public offering; and
- When more than 50 different persons are solicited in Belgium.

There are three exemptions to the public offering qualification, which exempt the offering from the regulations applicable to public offerings as soon as one of the following conditions is met, namely:

- When the offering is subject to a minimum investment of BEF 10 million per investor;[12]
- When the offering is targeted only at professional investors acting for their own account (eg, pension funds, investment funds, and insurance companies); and
- When the acquisition of the financial instruments thus offered is a condition for the exercise of a profession or is necessary for the exercise of such profession.

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11 The following are deemed to be means of publicity or advertising: the spreading of information in the press or in publications or on the radio, television, or any other audio-visual support; the spreading of circulars or any other printed documents concerning the offering, including materials sent personally to the recipients (direct mail); and the spreading of information by way of telephone campaigns (cold calling) or by the use of a system of electronic information.

12 Note that, with the introduction of the Euro in Belgium, this sum will be replaced by Euro 250,000.

Furthermore, exemptions exist for securities issued by the Belgian state and the regional authorities, for the public sale or auction of instruments ordered by court or organised periodically by the Management Committee of the stock exchange, and for the public offering of Eurobonds. The Royal Decree of 9 January 1991 is currently under review. The basic choices made in the Decree will probably remain. The main improvement is the introduction of the notion of 'institutional investor'. An offer of securities made only to institutional investors, even if made to more than 50 of them, is not treated as a public offer, but rather retains its private character.

Notification of the Banking and Finance Commission

A person having the intention to publicly issue, to offer securities for sale, or to call on public savings to subscribe to a capital increase in Belgium must notify the *Commission Bancaire et Financière* at least one month in advance.[13] Together with this notification, the person also must submit a file containing:

- A draft prospectus;[14]
- The reasons for the call on public savings;
- The conditions of the underwriting;
- A detailed summary of the participations held in the issuer by those who have informed the *Commission Bancaire et Financière*; and
- Other elements which the *Commission Bancaire et Financière* deems necessary to be adequately informed of the conditions and reasons of the transaction.

The *Commission Bancaire et Financière* has one month to approve the prospectus. In case approval is refused, it is possible to appeal the decision to the Minister of Finance. The decision can be annulled by the Council of State. The *Commission Bancaire et Financière* has the possibility of recommending a reduction of the number of securities offered when it thinks that the proposed offering can destabilise the capital markets. The prospectus must include a notice that the approval of the prospectus by the *Commission Bancaire et Financière* does not imply any evaluation as to the opportunity or the quality of the operation.[15]

The approved prospectus must be rendered public at least three banking days before the closing of the subscription period and at the latest on the day of the opening of the subscription.[16] If the issuer is a Belgian company, the prospectus must be made available to the public at its registered office and at the financial institutions that will be its paying agents. Any new fact occurring after the approval of the prospectus by the *Commission Bancaire et Financière*, but before the closing of the transaction which could influence the public's

13 Royal Decree Number 185, art 26.
14 For prospectus requirements, see the Royal Decree of 31 October 1991, on the prospectus which must be published in case of a public issue of securities.
15 Royal Decree Number 185, art 29, s 2.
16 Royal Decree of 31 October 1991, art 11.

decision, must be disclosed under the form of an amendment to the prospectus. If this is not done, the *Commission Bancaire et Financière* can suspend the public transaction.[17]

Requirements Imposed on Non-Belgian Issuers

Specific rules of Belgian company law and stock exchange law apply to non-Belgian issuers. Article 199 of the Consolidated Laws on Commercial Companies provides that a public issue, an offer for sale, or a tender and sale of securities of foreign companies and the inclusion of such securities in an official listing of a stock exchange must be preceded by the filing for deposit of the instruments of incorporation of such companies at the clerk's office of the Commercial Court and will be subject to the regulations on public issues, offers for sale, and tender sales and inclusion of securities in an official listing applicable in Belgium. Any foreign company whose securities are included on the official list of a stock exchange must file its instruments for deposit at the clerk's office of the Commercial Court and its annual account with the National Bank of Belgium. The securities of companies which do not observe these obligations are not permitted to maintain a stock exchange listing. Article 199 of the Consolidated Laws on Commercial Companies applies to all non-Belgian issuers.

A company which does not belong to one of the member states of the EU and which desires to issue securities, to publicly sell securities, to engage in a take-over bid with respect to Belgian securities, or to list its securities on a Belgian stock exchange is required to file with the clerk of any Belgian commercial court the constitutional documents of the issuer and to seek the approval of the Belgian Ministry of Finance.[18] For the prospectus requirements, reference should be made to the Royal Decree of 31 October 1991 and, more importantly, to the Royal Decree of 14 November 1991 on the mutual recognition within the EU of public offerings prospectuses and of prospectuses for the admission of securities to official stock exchange listings.

Listing Regulations

The Prospectus

Any demand for a listing of securities on the primary or secondary market of the Brussels Stock Exchange or an admission to trading on the EURO.NM (Brussels) market of the Brussels Stock Exchange must be made to the *Commission Bancaire et Financière* at least one month in advance.[19] This demand is in itself a public issue. Therefore, a prospectus is necessary. In the case of the secondary market and the EURO.NM, a public offering prospectus is necessary. For a listing on the first market of the Brussels Stock Exchange, the prospectus must comply with the requirements of the Royal Decree of 18 September 1990. For foreign companies, reference should be made to the Royal Decree of 14 November 1991 on the mutual recognition within the European Community

17 *Commission Bancaire et Financière*, *Rapport Annuel* (1992–1993), at p 87.
18 Law of 4 December 1990 on Financial Transactions and Financial Markets, art 4.
19 Royal Decree Number 185, art 26.

of public offerings prospectuses and of prospectuses for the admission of securities to official stock exchange listings. Reference also should be made to the Royal Decree of 13 February 1996, which establishes a method for accelerating the procedure for the approval of the admission prospectus.

The prospectus must be submitted to the *Commission Bancaire et Financière*. If the admission at the Stock Exchange is not accompanied by a public issue, the approved prospectus must be rendered public at least one day before the admission at the Stock Exchange becomes effective. If the admission at the Stock Exchange is accompanied by a public issue, the prospectus must be rendered public three banking days before the closing of the subscription period and at the latest the day of the opening of the subscription. For the prospectus requirements, reference should be made to the Royal Decree of 31 October 1991 and, more importantly, to the Royal Decree of 14 November 1991 on the mutual recognition within the EU of public offerings prospectuses and of prospectuses for the admission of securities to official stock exchange listings.

Request to the Management Committee of the Stock Exchange

The applicable rules and regulations for companies whose securities are (to be) listed on the first market of the Brussels Stock Exchange can be found in the Law of 6 April 1995 on Secondary Markets, the Status and Supervision of Investment Firms, Intermediaries and Advisers and the Royal Decree of 22 December 1995 on the admission of financial instruments on the first markets of the Stock Exchange.

In addition to the procedure before the *Commission Bancaire et Financière* in view of the approval of the prospectus, the company whose securities will be admitted to the first market of the Brussels Stock Exchange also should remit a file to the Management Committee (*comité de direction*) of the Brussels Stock Exchange. The file should contain the draft prospectus, the articles of association of the issuer, proof that the securities have already been admitted to a Stock Exchange of another member state of the EU (should such be the case), an undertaking of the financial intermediary declaring that it is acting as paying agent for the securities, and a copy of the annual accounts for the last three years. Additional information may be requested by the Management Committee of the Exchange. The *Commission Bancaire et Financière* also must be informed of any request of listing of securities on the Exchange. The Exchange must respond within two months to the issuer's request for admission to the first market of the Stock Exchange.

Specific rules apply for non-Belgian companies. Article 199 of the Consolidated Laws on Commercial Companies provides, *inter alia*, that the inclusion of securities in an official listing of a Belgian stock exchange must be preceded by the filing for deposit of the instruments of incorporation of such companies at the clerk's office of the Commercial Court. A foreign company, the securities of which are included on the official list of a stock exchange, must file its instruments for deposit at the clerk's office of the Commercial Court and its annual account with the National Bank of Belgium. The securities of companies which do not observe these obligations may not maintain a stock exchange listing. The Belgian Ministry of Finance must approve the listing of securities at a Belgian Stock Exchange of a company which does not belong to one of the member states of the EU and

which desires to list its securities on a Belgian stock exchange.[20] Shares issued by a company which is subject to the legislation of a state which is not a member state of the EU and whose shares are not listed in its home country, can only be admitted to the first market of the Brussels Stock Exchange on the condition that the Management Committee is assured that the fact that these shares are not listed in its home country is not due to the necessity to protect the investors.[21]

Admission Requirements

In order for a company to have its shares and bonds admitted to the first market of the Brussels Stock Exchange, it is necessary that:

- All formalities required by the Royal Decree of 22 December 1995 and the Consolidated Laws on Commercial Companies be respected;[22]
- The issuing company, irrespective of its nationality, have complied with all relevant legislation, specifically with respect to its constitution and corporate activities;
- The shares and bonds be freely transferable and tradable;
- In the case of convertible bonds, the underlying shares have been admitted to the first market;
- In the case of shares and bonds, they have been issued but have not yet been admitted to the first market;
- The market value or — if this cannot be ascertained — the company's own funds, inclusive of profits from the previous year, equal at least ECU 1 million;
- In the case of bonds, the loan equals at least ECU 1 million;
- If the listing is requested for shares, the company have published and deposited its annual accounts for the last three years in accordance with the applicable laws; and

20 Law of 4 December 1990 on Financial Transactions and Financial Markets, art 4; such company also is required to file its constitutional documents with the clerk of any Belgian commercial court.

21 Royal Decree of 22 December 1995, art 13 *in fine*.

22 One of the consequences for a Belgian company of having its securities listed on an official exchange is that the company shall for company law purposes be considered as a company which has made a public offer of securities (article 26) and therefore must respect the specific rules and provisions of the company law with respect to public companies. Article 26, s 2, stipulates that a company limited by shares will be deemed to make or to have made a public offer of its securities if it has made a public offer in Belgium or abroad by way of a public offer to subscribe for, a public offer to sell, a public offer to convert, or an introduction to, the listing on a securities exchange of bonds or securities, whether or not these form part of its capital or voting rights are vested therein, and of securities which give the right to subscribe for or to acquire such securities or to convert such securities. A company which intends to make a first public offer must first change its articles to provide therein that its object permits it to act as a company limited by shares that makes or has made a public offer and, if necessary, to adapt the same to the statutory provisions and regulations applicable to such companies. It must further register with the Banking and Finance Commission.

- The shares and bonds be regularly and continuously traded in one or more member states of the EU or are listed in another state and are regularly and continuously traded there.[23]

Specific admission rules exist for certificates representing shares or bonds which are issued by financial intermediaries, such as fiduciary companies. These rules are similar to the rules applicable in case of the listing of shares and bonds, but have been adapted to the specific situation in which the issuer of the certificates is an intermediary for the company issuing the shares or bonds represented by the certificates. Such certificates are the European equivalent of American Depository Receipts. They are sometimes referred to as International Depository Receipts. They are most frequently issued in Belgium by fiduciaries created by and managed by financial institutions.

Notwithstanding the above criteria, the Managing Committee of the Stock Exchange, under certain circumstances, may depart from these rules. The Managing Committee has relatively significant discretionary power in this respect.[24] Financial instruments for which a listing has been requested also must comply with certain formal requirements (eg, form of the security and of the coupon, height, drawings, and quality of paper).

Once the securities of the company which has made a public offer of its securities[25] are admitted to the first market of the Brussels Stock Exchange, the company must respect certain continuing obligations as to disclosure, as to the payment of fees to the *Commission Bancaire et Financière* and the Stock Exchange, and with respect to trading rules.

Disclosure Requirements

In General

The main obligation deriving from the fact that a company has made a public offering or that its shares are listed on an official exchange is that to disclose information to the

23 There is a legal assumption that shares or bonds are regularly and continuously traded in one or more member state of the European Union when at least 25 per cent of the shares or bonds belonging to the category for which the listing is requested are held by the public. However, the Management Committee may use other criteria to determine whether the securities are regularly and continuously traded. Furthermore, one should not comply with this condition when the public circulation will occur shortly through the intermediary of the Stock Exchange (Royal Decree of 22 December 1995, art 17).

24 Royal Decree of 22 December 1995, arts 18 *et seq*.

25 See article 26 of the Consolidated Laws on Commercial Companies, providing that a company limited by shares will be deemed to make or to have made a public offer of its securities if it has made a public offer in Belgium or abroad by way of a public offer to subscribe for, a public offer to sell, a public offer to convert, or an introduction to, the listing on a securities exchange of bonds or securities, whether or not these form part of its capital or voting rights are vested therein, and of securities which give the right to subscribe for or to acquire such securities or to convert such securities.

public. Some legal commentators go beyond these specific rules and hold that there should be a general obligation of transparency.[26]

Various Disclosure Requirements

When dealing with disclosure, several distinctions must be made. The first distinction exists between the disclosure to be made by the company itself and the disclosure requirements of its shareholders. The latter undertaking is known as the disclosure of major holdings of shares and is based on the Council Directive of 12 December 1988, on the information to be published when a major holding in a listed company is acquired or disposed of.[27] A second distinction regarding financial disclosure must be drawn, on the one hand, between the listing and public offering disclosure, without foregoing the distinction between these two sets of disclosure requirements and, on the other hand, the disclosure of *ad hoc* and periodical information. As indicated, this distinction itself embodies two further distinctions.

Listing Disclosure and Public Offering Disclosure: Prospectus Requirements

Legal Framework

Both sets of disclosure rules are based on European Directives.[28]

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26 Prioux, *La transparance*, *principe général de droit en matière d'information des actionnaires et du marché?*; see also the *Transpac* squeeze-out case, in which the court granted the minority shareholders the right to demand additional information in addition to the prospectus to be able to better calculate the offer price (Brussels, 28 October 1996, *TRV* (1996), at pp 653 *et seq*).

27 European Community Directive 88/627/EEC, OJ L348, 17 December 1988, at pp 62–65.

28 For the listing or admission to an official stock exchange, see Council Directive of 5 March 1979, co-ordinating the conditions for the admission of securities to official stock exchange listing (79/279/EEC, OJ L66, 16 March 1979, at pp 21–32), amended by the Council Directive of 3 March 1982 (82/148/EEC, OJ L62, 5 March 1982, at pp 22–33); see also the Council Directive of 17 March 1980, co-ordinating the requirements for the drawing up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to an official stock exchange listing (80/390/EEC, OJ L100, 17 April 1980, at pp 1–26), amended by the Council Directive of 22 June 1987 (87/345/EEC, OJ L185, 4 July 1987, at pp 81–83), and further amended by Council Directive of 23 April 1990, amending Directive 80/390/EEC in respect of the mutual recognition of public-offer prospectuses as stock exchange listing particulars (90/211/EEC, OJ L112, 3 May 1990, at pp 24–25). See also the Council Directive of 30 May 1994, amending Directive 80/390/EEC, co-ordinating the requirements for the drawing up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, with regard to the obligation to publish listing particulars (94/18/European Community, OJ L135, 31 May 1994, at pp 1– 4). For the public offering prospectus, see the Council Directive of 17 April 1989, co-ordinating the requirements for the drawing up, scrutiny, and distribution of the prospectus to be published when transferable securities are offered to the public (89/298/EEC, OJ L124, 5 May 1989, at pp 8–15).

Public Offering Prospectus

The Belgian rules on the public offering prospectus are determined by the Royal Decree of 31 October 1991. Such prospectus applies for any public offering, such as a public capital increase or a public tender, but also when such offer is combined with a request for admission to trading on EURO.NM Belgium. Indeed, similar to the admission to trading on EASDAQ, the admission to trading on EURO.NM Belgium is based on the concept of a public offering of securities. However, where a public offering takes place concurrently with an admission to an official exchange (the first market of the Brussels Stock Exchange), the relevant prospectus to publish should be the listing prospectus.[29] The minimum content of the public offering prospectus is laid down in the

Annexes to the Royal Decree.[30] Some exceptions and specific rules are described in the Royal Decree of 31 October 1991.[31]

Similar to the listing prospectus, the public offering prospectus must contain all elements necessary for the public to have a well-informed opinion on the assets, financial position, performance, and prospects of the issuer. Therefore, the prospectus should contain provisions on the persons under whose responsibility the prospectus has been made and on the control of the accounts. This will normally be respectively the directors and accountants of the issuer. The prospectus also should include details on the securities which will be offered to the public (eg, description of the rights attached to the securities, possible limitations to the free transferability, and tax aspects), and details on the financial institution which will act as paying agent in Belgium, including details on the transaction (nature, purpose, preferential rights of existing shareholders, limitations of such rights, transaction price, method of payment, subscription period, delivery of securities, underwriting conditions, and total net proceeds of the transaction for the issuer). The prospectus also should include general provisions on the issuer and its share capital, its business, activities, and foreseen investments. Details on the financial position and the results of the issuer also must be inserted (eg, balance sheets, consolidated balance sheets, and semi-annual results). Specifications on the management and control of the issuer also must be included in the prospectus.

Specifically for EURO.NM Belgium, the prospectus must contain a business plan which must contain objective data on the market where the issuer is active and information on the position of the issuer on the market. Together with the EURO.NM prospectus, financial notes prepared by the sponsor/market-maker must be submitted. Any new fact that could have an impact on the valuation of the securities which occurs between the moment the prospectus has been approved by the *Commission Bancaire et Financière* and the closing of the public issue must be disclosed in an addendum of the prospectus. Any addendum to the prospectus, as well as any other communication or other pieces which announce a public issue may only be rendered public after the approval of the *Commission Bancaire et Financière*.

29 Royal Decree of 31 October 1991, art 8, s 1.
30 See Annex A for shares, Annex B for obligations, and Annex C for certificates.
31 Royal Decree of 31 October 1991, arts 5, 7, 8, and 9.

Listing Prospectus

The Belgian requirements regarding a listing prospectus are laid down in the Royal Decree of 18 September 1990. As stated above, in the case where a public offering of securities takes place at the same time as the listing of the securities, the relevant prospectus to be drawn up is a listing prospectus containing the (minimum) elements described in the Royal Decree of 18 September 1990. Depending on the nature of the issuer and the securities for which the listing is requested, the listing prospectus must contain all elements that give the investors and their advisors an opinion on the assets, financial position, performance, and prospects of the issuer and the securities.[32]

The minimum content of the prospectus is provided in the annexes to the Royal Decree. The *Commission Bancaire et Financière* has the possibility within certain limits described in the Royal Decree to grant exceptions to the obligation to make a listing prospectus.[33] This content is similar to the content of the public offering prospectus. The listing prospectus for securities admitted to the first market of the Brussels Stock Exchange must be drawn up in one of the official languages of Belgium (French or Dutch).

Mutual Recognition

The principle of mutual recognition of prospectuses is provided in the Council Directive 80/390/EEC of 17 March 1980, as amended, and Council Directive 89/298/EEC of 17 April 1989. The basic rule is that a public offering prospectus or listing prospectus approved by a competent authority, such as the *Commission Bancaire et Financière*, of one member state of the EU must be recognised in all other member states of the EU where a public offering is taking place simultaneously. In Belgium, the provisions of the mutual recognition of prospectuses are provided in the Royal Decree of 14 November 1991.[34]

The competent authority in Belgium for mutual recognition is the *Commission Bancaire et Financière*. Article 3, section 1, of the Royal Decree of 14 November 1991, stipulates that the request for recognition should be submitted to the *Commission Bancaire et Financière* at least 15 days prior to the public offering. In the case of public offering prospectuses which, in accordance with the national legislation of the issuer, do not need to be approved by a national competent authority, no mutual recognition in Belgium is possible. A way to get round this problem is to draft the local prospectus as a listing prospectus and have it approved as such by the local competent authority. Mutual recognition in Belgium by the *Commission Bancaire et Financière* is then possible and the prospectus can be used for the public issue of the securities in Belgium (or admission to trading on EASDAQ or EURO.NM Belgium). There are limitations to the mutual recognition. The competent authority may require the translation of the prospectus into one of the national languages.

32 Royal Decree of 18 September 1990, art 4.
33 Royal Decree of 18 September 1990, arts 6 and 7.
34 Royal Decree Number 185, art 34 *bis*.

The competent authority also may require that significant information with regard to the local market (and local shareholders) be inserted in the prospectus.

Ad Hoc and Periodic Information Disclosure

Applicable Legislation

One of the main continuing obligations of a listed company is the reporting requirement of periodic and occasional information towards the *Commission Bancaire et Financière* and the Management Committee of the Stock Exchange. These requirements are provided in the Royal Decree of 3 July 1996, regarding the obligations on occasional information of issuers whose financial instruments are listed on the first market or the new market of a stock exchange (the so-called 'Royal Decree on Occasional Information'), and the Royal Decree of 3 July 1996, regarding the obligations on periodic information of issuers whose financial instruments are listed on the first market or the new market of a stock exchange (the so-called 'Royal Decree on Periodic Information'). The relevant authority for the periodic information is the *Commission Bancaire et Financière* and, for the occasional information, it is the Managing Committee of the exchange.

Periodic Information

The Royal Decree on Periodic Information provides for listed companies, admitted on the first market and the EURO.NM, the publishing of a biannual report on their business and their results during the first half of each business year within four months after the end of the relevant half year. This biannual report should consist of quantitative data, including the net turnover and the profits before and after tax, as well as a report on the company and the results during the previous half year. Companies whose securities have been admitted for trading on the EURO.NM also must communicate to the Commission Bancaire et Financière a thrice-monthly report on the first and third quarters of each business year. Beside the biannual and eventual quarterly reports, the listed companies also should disclose information annually: the annual accounts and annual report, on a consolidation and non-consolidated basis.

The publication procedure is determined by the Royal Decree on Periodic Information and by the Consolidated Laws on Commercial Companies to which Belgian companies are subject. The reports must be disclosed to the *Commission Bancaire et Financière* and to the Managing Committee of the Stock Exchange. They also must be published in a widely circulating Belgian newspaper and be communicated both to a Belgian press agency and through an electronic transmission system.

Occasional Information

The Royal Decree on Occasional Information lays down the rule that companies whose financial instruments are admitted to the first market of a Belgian exchange and the new market of a Belgian exchange (EURO.NM Belgium) should respect the equal treatment

of all its investors. This should be done by providing the necessary information to guarantee the transparency and adequacy of the market.[35] Therefore, they must disclose the so-called 'occasional information'. The following information should be disclosed:

- All information regarding the exercise by the holders of financial instruments of their rights or of rights attached to the holding of financial instruments;
- Any information regarding the rights attached to the holding of financial instruments (eg, the right to convert its security); and
- All facts or decisions known to the issuer that, if disclosed, could influence in a sensitive way the price of the financial instruments.

The following are refutably considered to be sensitive information in the sense of the Royal Decree on Occasional Information:

- The communication of results;
- The communication of the amount of the dividend; and
- The communication of any amendment to the rights related to different classes of securities.

Foreign companies that fall within the scope of application of the Royal Decree on Occasional Information must carefully see to it that the Belgian market receives equal information as the market of other states where the company is listed. The method of disclosure when dealing with periodic information has already been described above; similar rules apply to occasional information. Occasional information must be disclosed in one or more Belgian newspapers with a large circulation in Belgium, to Belgian press agencies, and by electronic transmission systems. It is important that the disclosure occurs after the closing of the exchange (4:30 pm).

In case certain information is at the same time periodic information and sensitive information which must be disclosed on the basis of the Royal Decree on Occasional Information, the issuer should comply with the disclosure procedures determined by the Royal Decree on Occasional Information. Therefore, in practice, the periodic information (which, in most cases, will be sensitive information) will be disclosed by respecting the procedure determined in the Royal Decree on Occasional Information and possibly in a cumulative manner (although this is not compulsory), by also respecting the procedure provided in the Royal Decree on Periodic Information.

The *Commission Bancaire et Financière* and the Managing Committee exercise an *a posteriori* control on the information transmitted, the *Commission Bancaire et Financière* regarding compliance with the Royal Decree on Periodic Information and the Management Committee regarding compliance with the Royal Decree on Occasional Information.

35 Royal Decree of 3 July 1996, arts 2 and 3.

Trading Rules

In General

When dealing on a Belgian stock exchange market or regulated market, one must adhere to a number of trading rules. Except for the mandatory use of financial intermediaries, which applies to any investor who wishes to carry out transactions on financial instruments issued by a Belgian company and listed on a Stock Exchange or other regulated market, these rules apply to financial intermediaries acting on behalf of the investors (however, there are exceptions).

Rules of Conduct

Article 11 of the Investment Services Directives provides that the EU member states must implement rules of conduct for investment firms. The minimum rules are described in the Investment Services Directive. Article 11 of the Investment Services Directive in fact finds its origin in Recommendation 77/534/EEC of 25 July 1977 of the European Commission, which contains a (non-binding) code of conduct for investment transactions.

In application of article 11 of the Investment Services Directive, the Law of 6 April 1995 on Secondary Markets, the Status and Supervision of Investment Firms, Intermediaries, and Advisors specified the rules of conduct applicable to all investment services. The rules are based on the ratio legis of article 11 of the Investment Services Directive, on the aim of enhancing the transparency, integrity, and security of the Belgian financial markets, on the idea of giving the Belgian markets a level playing field to operate on, and on the principles elaborated by the SIB under the Financial Services Act of 1986. Seven general rules of conduct are provided by article 36 of the Law of 6 April 1995. A financial intermediary should:

- Act honestly and fairly in conducting his business activities to promote fair practices on and the integrity of the markets in an optimal manner;
- Act with due skill, care, and diligence in the best interest of his clients, taking into account the professional nature of the person for whom the service is provided;[36]
- Comply with all codes of conduct and any other rules applicable to the conduct of his business activities (ie, the entering into transactions in financial instruments) with a view to defending the interest of his clients and the integrity of the markets in an optimal manner;
- Seek from the clients he advises all useful information regarding their financial situation, investment experience, and objectives as regards the services requested which are reasonably relevant to fulfilling his obligations towards his clients in an optimal manner;

36 With regard to financial instruments admitted to listing on the Stock Exchange or traded on another regulated market, the financial intermediary will be considered to have complied with this obligation if he has executed the transaction on a regulated market, unless he has been otherwise instructed by his client.

- Take reasonable steps to provide his clients, within a reasonable period of time, with all information enabling them to take a well-considered and informed decision;[37]
- Attempt to avoid conflicts of interest and, when they cannot be avoided, ensure that his clients are fairly and equally treated and, if applicable, take all other steps such as reporting, complying with internal rules of confidentiality, or refusing to act;[38] and
- Have and employ effectively the resources and procedures which are necessary for the proper performance of his business activities.[39]

The rules should be viewed as general legal principles applicable to all investment services. The regulatory bodies (market authorities) of every regulated market have the power to further elaborate detailed conduct rules in their market regulations. This has, for example, been done for Belfox in articles 3 *et seq* of the Ministerial Decree of 9 April 1996, articles 1 *et seq* of the EASDAQ rule book,[40] and articles 3 *et seq* of the off-market for public debt instruments.[41]

Other Transaction Rules

Mandatory Use of Authorised Financial Intermediaries

Article 2 of the Law of 6 April 1995 on Secondary Markets, the Status and Supervision of Investment Firms, Intermediaries, and Advisors provides that investors established in Belgium who wish to carry out a transaction with regard to financial instruments issued by a Belgian company or institution listed on a Belgian stock exchange must use an authorised financial intermediary; this will be a licensed credit institution (eg, Belgian credit institutions, EU credit institutions operating through a branch or on the basis of the free provision of services, and authorised non-EU institutions), investment firm (eg, stockbrokerage firm), foreign investment firms operating in Belgium on the basis of the Investment Services Directive (and the Law of 6 April 1995), or intermediary acting on regulated markets. The requirement to use a financial intermediary does not apply to:

- Occasional transactions between private individuals;
- The sale of financial instruments representing at least 10 per cent of the voting rights of the issuer;

37 At the simple request of a client, the financial intermediary must be readily available to give a full and honest report of his undertaking towards the client. He may not suggest or promote any action which might incite the client not to fulfil his legal obligations, including his obligations towards the state.

38 The financial intermediary may not have his own interests in an unfair manner prevail over his clients' interests and, if a well-informed client may reasonably expect that such intermediary would allow his clients' interests to prevail, the intermediary must act in accordance with that expectation.

39 The drafting of these rules is in very broad terms and goes (far) beyond the text of the rules of article 11 of the Investment Services Directive.

40 Ministerial Decree of 15 October 1996.

41 Ministerial Decree of 24 January 1996.

- Transactions between the different sections of the same collective investment institution; and
- The public issue of securities.

The purpose of this mandatory use of financial intermediaries is to enhance the protection of the investor; a financial intermediary should respect the rules of conduct and the other trading rules and must carry out the transaction on a regulated market.

Mandatory Use of Regulated Markets

Financial intermediaries acting on behalf of investors residing or established in Belgium must carry out a transaction with respect to a financial instrument listed on a Belgian stock exchange or traded on another Belgian regulated market, or on a Belgian regulated market or a regulated market of another member state of the EU.[42] The investor, however, may explicitly stipulate that a transaction be carried out outside a regulated market. When a financial intermediary acting on behalf of an investor residing or established in Belgium does not respect the concentration rule, the investor may refuse to be bound by the concluded transaction.

Acting as Counterparty of Client

Financial intermediaries may act as counterparty of their client only on a regulated market, or otherwise only after having informed the client beforehand.

No 'Netting'

Financial intermediaries may not compensate orders in financial instruments traded on a Belgian regulated market (with some exceptions).

Reporting Requirements for Executed Transactions

The financial intermediary has a reporting requirement towards his client and towards the market authorities. The client must be informed of the details of the executed transaction at the latest on the next business day following the day of the transaction. In case of a transaction executed outside Belgium, the client should be informed the next business day following receipt of confirmation of the transaction.

In addition to the reporting requirement towards the client, the financial intermediary should report all transactions carried out by such intermediary in financial instruments to the market authority where the transaction took place. The specific rules are based on article 20 of the Investment Services Directive and elaborated in a Royal Decree of 25 February 1996, on the communication of transactions and the keeping of information.

42 The Law of 6 April 1995, art 37, utilising the opportunity offered by art 14.3. of the Investment Services Directive.

Disclosure of Substantial Holdings and Public Take-Over Bids

In General

The Belgian legislation regarding the acquisition, maintenance, and disposal of a substantial holding in a listed company is based on three options, namely:

- The transparency of the financial markets;
- The duty of information towards all shareholders; and
- The equality among shareholders.[43]

The Belgian legislation regarding the acquisition, maintenance, and disposal of a substantial holding is basically provided in one law and three royal Decrees executing this law, namely:

- The Law of 2 March 1989, on the disclosure of major holdings in companies listed on a stock exchange and on public take-overs bids (hereafter referred to as the 'Law of 2 March 1989');
- The Royal Decree of 10 May 1989 (hereafter referred to as the 'Disclosure Decree'); and
- The Royal Decree of 8 November 1989 (hereafter referred to as the 'Take-Over Decree').

Disclosure of Acquisition of Substantial Holdings

Scope of Application

Chapter I of the Law of 2 March 1989, as well as the Disclosure Decree, deals with the disclosure by a shareholder of a Belgian listed company of substantial shareholdings in such company. This legislation implements in Belgian law the Council Directive of 12 December 1988, on the information to be published when a major holding in a listed company is acquired or sold.[44] A system is organised in which holders of shares or other stock carrying effective or potential voting rights in companies listed on a stock exchange are obligated to disclose the interests they hold whenever, as a result of the acquisition or disposal of such shares or stock, they reach or exceed, or fall below, certain thresholds. These thresholds are determined by national law.

Contrary to the disclosure of information in the listing prospectus, the *ad hoc* information of major significance (so-called 'occasional information')[45] or the periodical information on the basis of the Royal Decree of 3 July 1996, regarding the obligations on periodic information of issuers whose financial instruments are listed on the first market or the new

43 Law of 2 March 1989, art 15.

44 Euopean Community Directive of 12 December 1988, *Official Journal*, L 348/62, 17 December 1988.

45 Royal Decree of 3 July 1996, regarding the obligations on occasional information of issuers whose financial instruments are listed on the first market or the new market of a stock exchange.

market of a stock exchange, the Directive of 12 December 1988, the Belgian Law of 2 March 1989, and the Disclosure Decree impose obligations on shareholders of listed companies, but not on the issuers. This legislation is more a rule of company law, the application of which is restricted to listed companies, than a stock exchange disclosure law.

The Law of 2 March 1989 and the Disclosure Decree only apply to Belgian companies whose securities are listed on an official stock exchange of a member state of the EU. The nationality of the listed company is of great importance here. Under Belgian private international law, a company has the Belgian nationality when its corporate seat is situated on Belgian territory.[46] In contrast with the nationality of the listed company, which must be Belgian, the nationality (or home country requirements) of the shareholder holding, a substantial shareholding is irrelevant. Belgian companies listed on a non-Belgian EU stock exchange fall within the scope of the Belgian disclosure regulations. Even so, European companies listed on the Brussels Stock Exchange will have to adhere to their national disclosure requirements, although these requirements will be similar to the Belgian ones, as they will both be based on the EU Council Directive of 12 December 1988, on the information to be published when a major holding in a listed company is acquired or sold.[47] The legal status of the disclosing shareholder or person also is not relevant.

Belgian companies whose securities are traded on EASDAQ or EURO.NM do not fall within the scope of this regulation. On the basis of this legislation, shareholders of such companies do not need to disclose their substantial holdings in such companies. Indeed, as already mentioned, the admission to trading on EASDAQ and EURO.NM is based on the principle of a public offering of securities and not on the concept of the admission of securities to the official listing on a stock exchange. Therefore, these companies cannot be considered as being Belgian companies whose securities are listed on an official stock exchange. However, both markets for young and innovative companies have very specific rules on the disclosure of significant shareholdings. Companies falling within the scope of the application of chapter I of the Law of 2 March 1989 and the Disclosure Decree must adhere to the principles provided in these regulations.

Disclosure Regulation of Law of 2 March 1989 and Disclosure Decree

Relevant Securities. Relevant securities include not only securities having actual voting rights are relevant, but also securities which bear potential voting rights, such as convertible bonds and warrants.

Disclosure Requirement. Any person owning, acquiring, or transferring securities which represent five per cent or more, or a multiple of five per cent (eg, 10, 15, or 20 per cent) of the total voting rights of all securities of a listed company should disclose their shareholding to the *Commission Bancaire et Financière* and to the listed company. The

46 Consolidated Laws of Commercial Companies, art 196.

47 The threshold can differ, however; the United Kingdom, for example, has gone down to three per cent.

initial threshold of five per cent can be lowered to three per cent (and multiples of three per cent) in the articles of incorporation of the issuer. Such disclosure should take place at the latest two days after the transaction whereby the (new) threshold was reached.

The disclosure requirement is applicable to persons having directly (or indirectly) five per cent or more of the voting rights. Also, the securities held by persons acting jointly are to be taken together for the purpose of establishing whether a person has 5 per cent or more of the voting rights. Persons acting together can act together on the basis of shareholders agreements, blocking conventions, fiduciary agreement, and agreements relating to the certification of shares.[48]

Duties of Company Whose Securities Are Object of Disclosure. The issuer, informed by the disclosing shareholder, must at the latest on the next working day publish the notification (which should appear in two nationally distributed newspapers). In the annexes to the annual accounts, the company should detail the situation of its capital and the structure of its shareholding.[49]

Sanction on Non-Disclosure. A shareholder who does not disclose the ownership or acquisition or transfer of relevant securities at least 45 days before a general meeting will lose that part of the voting rights attached to the securities which gave rise to the disclosure obligation.

However, this sanction does not apply with regard to securities obtained by way of exercising a right of pre-emption, by way of inheritance, merger, division, liquidation, or public offer.[50] The Law of 2 March 1989 also has criminal sanctions for shareholders with substantial holdings who intentionally do not disclose.[51]

Disclosure Regulations for Companies Whose Securities Are Traded on EASDAQ or EURO.NM

In General. Belgian companies whose shares are traded on EASDAQ or EURO.NM Belgium (and are not simultaneously listed on an official stock exchange) do not fall within the scope of application of the Law of 2 March 1989 and the Disclosure Decree. Nevertheless, the Law of 2 March 1989 expressly permits companies which do not fall within the scope of application of this law to voluntary submit to the disclosure system of the Law of 2 March 1989 and the Disclosure Decree. Moreover, due to the very specific nature of these two markets, specific disclosure regulations will apply. These are provided for each market.

48 Disclosure Decree and the Royal Decree of 8 October 1976, arts 5 and 7; see also the notion of 'persons acting in concert' in the 13th European Community Directive on Company Law.
49 *Commission Bancaire et Financière*, *Circulaire* of 4 October 1990.
50 Law of 2 March 1989, art 6.
51 Law of 2 March 1989, art 11.

Issuers of Securities Traded on EASDAQ. Article 3, sub-clause 2.6, of Book II of the EASDAQ Regulation stipulates that the public offering prospectus which must be drawn up for admission to trading on EASDAQ must identify, in so far as this is known to the issuer, the natural or legal person who, directly or indirectly, severally or jointly, exercises or could exercise control over the issuer, and the particulars of the proportion of the capital giving a right to vote. A brief description of the nature of such control also should be given. The notion of joint control is to be understood as the control exercised by more than one company or by more than one person that has concluded a written or unwritten agreement which may lead to their adopting a common policy in respect of the issuer.

In addition, and in so far as they are known to the issuer, the identity of any person or group that is known to the issuer, either directly or indirectly, to own

or to control five per cent or more of any clause of the issuer's financial instruments also must be stated. The financial instruments held by persons acting jointly are to be taken together for the purpose of establishing whether a person controls the issuer or owns or controls five per cent. The same threshold as the one applicable under the Law of 2 March 1989 is relevant here. Each class of equity financial instruments of the issuer, or any of its parents or subsidiaries, owned by any of the issuer's directors, executives, or managers and their nominees also must be disclosed. The prospectus also should contain a description of any arrangements, in so far as these are known to the issuer, the operation of which, at a subsequent date, may result in a change of control of the issuer.

Issuers of Securities Traded on EURO.NM Belgium. The Royal Decree of 16 February 1996 stipulates that the articles of association of an issuer whose securities are traded on EURO.NM Belgium must contain mandatory disclosure rules. The articles of association of such a company must stipulate that each person or body corporate transferring or receiving securities should inform the issuing company and the market authority, in this case the Management Committee established within the Stock Exchange Corporation of Brussels, about the amount of voting rights it possesses, if these voting rights amount to five per cent, 10 per cent, or 15 per cent (per five per cent) of the total amount of voting rights attached to the securities of the issuer.

Specific disclosure requirements apply to the shareholder-managers. As already mentioned, specific rules were enacted for the founding shareholder(s) and the shareholders participating in the daily management of the issuer. In an undertaking, in the form of a letter to the Management Committee, the shareholders-managers must subscribe to a lock-up arrangement. They must undertake not to sell a certain minimum percentage of their holdings (which is to be agreed with the Management Committee) for a period of 12 months. In addition, they must undertake to notify the Management Committee of every transfer by them of the same percentage of securities of the issuing company, whether or not these securities are traded on EURO.NM Belgium, within five working days following this transfer.[52]

52 Stock Exchange Regulations, art 143.

Public Take-Over Bids

In General

A distinction must be drawn between the voluntary take-over bid and the mandatory take-over bid. A voluntary take-over bid takes place on the initiative of the bidder. A mandatory take-over bid must take place on the acquisition of a controlling stake in a listed company.

Voluntary Take-Over Bids

Scope of Application. The rules regarding voluntary take-over bids, which can be found in Chapter II of the Take-Over Decree, apply to companies, irrespective of their legal form and irrespective of whether or not their securities are listed or traded in public.[53] Three elements must be united in order for the Take-Over Decree to apply, namely:

- There must be an offer;
- The offer must be made to the public; and
- The offer must be related to certain 'securities' as defined in the Decree.[54]

Belgian law does not define the notion 'offer'. However, there is a consensus in the doctrine whereby it is considered that a public purchase offer is an offer made to the public to acquire against cash or other consideration securities held by the public. The 'public' character of an offer is determined on the basis of the Royal Decree of 9 January 1991 regarding the public nature of transactions carried out with a view to attracting savings. (Please note that this Royal Decree is currently under review; however, the basic choices made by this Decree will probably remain). According to this regulation an offer is public in the following circumstances (here summarised):

- When more than 50 different persons are solicited in Belgium;
- When, for the offering, use is made of any means of publicity or advertising of whatever nature aimed at the public in Belgium to announce or recommend the offering, such means being understood to include any publicity or advertising or spreading of information in the press or in publications or on the radio, or on the television or any other audio-visual support, or the spreading of circulars or any other printed documents concerning the offering, including materials sent personally to the recipients (direct mail) and the spreading of information by way of telephone campaigns (cold calling) or by the use of a system of electronic information; or
- When there is reliance on or intervention by professional intermediaries in Belgium.

53 In contrast to Chapter II, Chapter III of the Decree applies only to companies which have made a public offering of securities.

54 Royal Decree of 8 November 1989, art 1.

There are three exemptions to the public offering qualification; these exempt offerings from the regulations applicable to public offerings as soon as one of the following conditions is met, namely:

- When the offering is subject to a minimum investment of BEF 10 million per investor;
- When the offering is targeted only at professional investors acting for their own account (eg, pension funds, investment funds, and insurance companies); and
- When the acquisition of the financial instruments thus offered is a condition for the exercise of a profession or is necessary for the exercise of such profession.

Furthermore, exemptions exist for securities issued by the Belgian state and the regional authorities, for the public sale or auction of instruments ordered by court or organised periodically by the Management Committee of the stock exchange, and for the public offering of Eurobonds. The 'securities' envisaged by the Take-Over Decree are securities to which voting rights are attached and securities which contain a right for the holder to acquire voting stock, such as warrants and convertible bonds.[55]

Conflict of Laws Aspects. The scope of application contains certain elements which involve an aspect of international private law. Firstly, the Belgian take-over regulation should be considered as a *loi de police*, having a peremptory character. As soon as the offer for securities has a public character in Belgium, this legislation must be applied. It will therefore not be possible to contract-out of the take-over Decree by choosing a different contract law on the transaction. A raider cannot opt to acquire the shares of the shareholders under foreign law. Even if the target is a foreign company, as soon as the take-over enters into the scope of application of the Belgian take-over legislation, such legislation must apply.

Secondly, the question as to whether the Belgian take-over legislation applies also involves certain elements of international private law. Reconsidering the scope of application, it is primarily in the assessment of the notion of 'public' that the international aspect appears. The notion 'offer' is self-explanatory. The offer must be made with regard to 'securities'. It is irrelevant here whether the securities are subject to Belgian law or to foreign law.

When more than 50 persons are solicited, the bid will be regarded as public. However, more than 50 people must be solicited in Belgium. The same applies for the second criterion: the publicity, cold calling, or direct mail. These must be done in Belgium. Here, the recipient will be considered. Hence, cold calling from abroad to Belgium falls within the scope. The answer to the question as to whether the public is approached in Belgium or not remains of course very factual (eg, whether a certain newspaper is circulated in Belgium).

55 The Stock Exchange Law of 1995 no longer defines or uses the notion of 'securities', but rather uses the broader notion of 'financial instruments', which also includes forward rate agreements, swaps, options, and futures.

Consequently, even if target and bidder are foreign companies, it could well be that the Belgian take-over legislation applies as long as the take-over bid falls within the scope of the Belgian Take-Over Decree. It will in the first place be the *Commission Bancaire et Financière* that will judge whether the Belgian procedure must be followed. However, even if the *Commission Bancaire et Financière* considers that no such offer is necessary in Belgium, a (minority) shareholder can still petition the court and require that a public bid be made in Belgium. However, due to mutual recognition of prospectuses, this will normally not be a problem in practice. A more realistic hypothesis is of course the case of a foreign bidder and domestic (Belgian) target. As a significant portion of the target's shares will probably be distributed in the public in Belgium, a public take-over bid in Belgium in accordance with the Take-Over Decree will be necessary.

Regulation of Take-Over Bids. Here, a distinction will be made between the conditions of the take-over bid and the procedure.

Conditions for Take-Over Bid. The public offer must extend to all voting securities of the company. However, the offeror has the right to restrict its offer to 10 per cent of the voting rights, taking into account those attached to securities he already holds.[56] The offer must be a firm offer. The offeror must have the intention to bring the bid to a successful end. However, the offeror has the right to make its offer conditional on the effective obtaining of a certain minimum percentage.[57]

The offeror must be able to show, to the satisfaction of the *Commission Bancaire et Financière*, that it has sufficient financial resources to successfully complete the take-over. Either the funds must be available on a blocked account, or the offeror must have an unconditional credit line at his disposal. In the case of an exchange offer, the offeror must be able to show that he can either issue the relevant securities or acquire them within the required period of time. The bid must be formal in order. It must comply with the procedure and formalities of the Take-Over Decree.

Take-Over Procedure. The offeror must notify the *Commission Bancaire et Financière* 15 days before the actual offer of his intention to make a public offer. A file containing information regarding the offered price (or other consideration), the conditions on fulfilment of which the offer will be completed, and other aspects of the bid should accompany the notification. At the same time, a draft prospectus relating to the forthcoming offer should be submitted to the *Commission Bancaire et Financière*. Unless the offer is *prima facie* inadmissible, the notification will be published by the *Commission Bancaire et Financière* the following day and passed on to the target and the stock exchange.

The notification by the *Commission Bancaire et Financière* of the bid to the company shall limit the powers of the board of directors and general meeting of the target. From the moment of receipt by the company of the notification of the *Commission Bancaire et*

56 Royal Decree of 8 November 1989, art 3.
57 Bruyneel, 'Les offres publiques d'acquisition', *JT*, (1990) no 62.

Financière, the target is legally prohibited from increasing its capital or issuing voting securities whereby the right of pre-emption is limited or lifted, except by a decision of a general meeting of shareholders.[58] Likewise, the company may not take a decision which would result in a substantial alteration of the assets and liabilities of the company. However, decisions validly taken by the company before the notification by the *Commission Bancaire et Financière* of the take-over bid may be executed. Likewise, the board of directors may proceed with an increase of the capital within the limits of its powers.

Under Belgian company law, the general meeting of the company can authorise the board to increase the capital of the company. This is the so-called 'authorised capital'.[59] However, once the company has been notified of a take-over bid, the increase of capital within the limits of the authorised capital is only possible if the authorisation to increase the capital does not date back more than three years and explicitly gives the Board of Directors the authority to increase the capital in the event of a take-over bid. Furthermore, the following conditions must be fulfilled:

- The shares to be issued must be completely and immediately paid in at the time of issuance;
- The subscription price must be at least as high as the offered take-over price; and
- The total amount of newly issued shares may not exceed 10 per cent of the total number of shares.[60]

Under the Take-Over Decree, once the company is notified of the intended offer, the Board of Directors of the target is required to take a position with regard to the offer and to make its position public.[61] The board must inform the Commission Bancaire et Financière and the offeror within five days of its position. It must verify the accuracy of the information contained in the draft prospectus. The members of the board, in their capacity as shareholders, must indicate whether or not they themselves accept the offer. The advice of the board of directors of the target will be rendered public in the prospectus or in a separate memorandum. After the notification of the offer to the target, the offeror may only change the conditions of the bid if this change implies an improvement for the shareholders.[62]

The role of the *Commission Bancaire et Financière* is a formal one. The *Commission Bancaire et Financière* will check the prospectus as to the correctness and completeness of the information provided in it. However, the *Commission Bancaire et Financière* will not evaluate the advisability or quality of the offer. The minimum content of a take-over prospectus is provided in an annex to the Take-Over Decree. When the prospectus is approved, together with an acceptance form, which shall form a part of the prospectus, it will be published and distributed through a financial institution chosen

58 Royal Decree of 8 November 1989, art 8, s 1.
59 Consolidated Laws of Commercial Companies, art 33 *bis*, s 2.
60 Royal Decree of 8 November 1989, art 8, s 2.
61 Royal Decree of 8 November 1989, art 14.
62 Royal Decree of 8 November 1989, art 12.

by the offeror. Furthermore, the general public must be informed through a notice published in one or more national newspapers.

Should the (draft) take-over prospectus not be approved by the *Commission Bancaire et Financière*, the offeror can appeal to the Minister of Finance. The duration of the bid should be at least 10, and a maximum of 20, days. Within five days of the closing of the offer, the offeror must communicate to the public. If the offeror has acquired more than 90 per cent of the voting securities through the offer, he must re-open the offer within one month. This should permit minority shareholders to dispose of their securities (the bid should be re-opened for five days) and also will permit the offeror to request a de-listing of the securities (in which case, the bid should be re-opened for 15 days).[63] A counter-offer by a third party must be submitted at least two days before the closing of the offer and must be at least five per cent higher.

Mandatory Take-Over Bids

In General. Chapter III of the Take-Over Decree applies where there is a change in control of a company which has made a public offering of securities. Under Belgian law, in the event control over a Belgian public company (ie, a company which has engaged in public solicitation which by definition is not the same as a listed company; see article 26 *bis* of the Consolidated Laws of Commercial Companies) has been transferred outside a public offer and the price paid by the person who has gained control was higher than the market-price of the shares, then the minority shareholders have the right to dispose of their shareholding under the same conditions as the former majority shareholder(s).

It should be noted that, contrary to the legislation in several other European states, the mere transfer of a controlling stake in a listed or public company is not enough to trigger the obligation of the transferee to acquire all outstanding shares of the controlled company. In order for the transferee to be obliged to launch a public bid on all outstanding shares, the controlling stake should be acquired at an overprice, a so-called 'control premium'.[64]

Scope of Application. Due to its imprecise formation, the scope of application of the Belgian legislation on mandatory bids is not always clear.[65] The *Cour de Cassation* has ruled that the Belgian take-over legislation, and more specifically article 41 of the Take-Over Decree which forms the basis for the mandatory bid, belongs to the Belgian legal public order.[66] It is not possible to contract-out of this legislation. Consequently, the parties dealing with a majority stake in a Belgian public company should take full account of Chapter III of the Take-Over Decree, even if they choose to adopt a foreign law.

63 Royal Decree of 8 November 1989, art 32.

64 The Belgian rules are currently under review. A proposal has been made to simplify the regulation in such a manner that the mere owning or acquiring of a certain threshold percentage — this threshold value remains to be decided — will trigger the bid.

65 Royal Decree of 8 November 1989, arts 38 *et seq*.

66 Cass, 10 March 1994: *Cobefin NV / Compagnie Financière Aurore International*, Arr Cass 1994, at p 236; Pas 1994, I, at p 237.

In the case of a cross-border transfer of a control stake in a Belgian public company, the transferor and transferee should bear in mind that the Belgian take-over legislation is a mandatory regulation,[67] and the Belgian law is the *lex societatis* (a company has under Belgian law the Belgian nationality if its registered seat is situated in Belgium), which determines the conditions under which one can become a shareholder (eg, the question as to whether an acceptance clause is effective.) The scope of application of chapter III of the Take-Over Decree contains two important elements, both of which can lead to uncertainties.

The first element is the seizure of control. Control is defined in the Take-Over Decree by reference to the accountancy legislation. Control is seen as the fact of having a decisive influence on the appointment of the majority of the Board of Directors of the company or on the policy decisions of the company.[68] The acquisition of the control by parties acting in mutual agreement is considered to be identical to the acquisition of control by one party. A capital increase decided by the general meeting will fall outside the scope of application of the regulation on mandatory bids. Therefore, in the case where the seizure of (joint) control is done with the co-operation of the majority shareholder of the company, this could be a successful escape route to avoid a mandatory public bid on all shares.

The second important element is the question as to whether a control premium has been paid. The consequence of this necessary condition for a mandatory bid is that the Belgian regulation on the private transfer of controlling holdings does not apply to market acquisitions at the stock exchange as there would be no overprice over the market price, unless the official stock exchange quotation did not reflect the market price. However, it is not always easy to determine when a control premium was paid and what the premium was in consideration for the transfer of control. A controlling stake could be bought at market price and the premium could be shifted to unrelated transactions.

The Regulation. A person acquiring control over a public company by paying a control premium is required to offer to acquire all remaining voting shares of the target company.[69] This can be done through a public bid in which the bid price will equal the highest share price at which the acquirer acquired his controlling stake. Alternately, this also can be done through a so-called 'maintenance of the quotation price' (*maintien de cours*) for a period of at least 15 days, and this must take place within 30 days.[70] The public bid follows to a great extent the procedure of the voluntary public bid.[71] For example,

67 European Community Treaty, art 7, s 1.
68 Royal Decree of 8 November 1989, art 2, s 1; Royal Decree of 8 October 1976.
69 Royal Decree of 8 November 1989, art 41.
70 Royal Decree of 8 November 1989, art 42; for an example of such price stabilisation in which the undertaking to maintain the price was linked to a put option in favour of the shareholders, see *Commission Bancaire et Financière*, *Jaarverslag* (1993–1994), at p 90.
71 Royal Decree of 8 November 1989, art 44.

the rule of article 32 of the Take-Over Decree that a bidder holding 90 per cent or more of the voting shares of a target company must reopen the bid within one month after announcing the result of the initial bid applies equally to a mandatory bid.

Squeeze-Out

The controlling shareholder of a listed company can have an interest in 'de-listing' its subsidiary. The first step to such de-listing could be a so-called 'squeeze-out' procedure. In the case of a squeeze-out procedure, a shareholder holding at least 95 per cent of the voting shares of a company bids for the remaining five per cent. The take-over bid is mandatory on the part of the minority shareholders, in the sense that after the squeeze-out bid they can no longer remain shareholders of the company, but it will only have a right to the price offered by the bidder. Three different procedures are possible, depending on whether the squeeze-out bid follows a 'normal' take-over bid.

The first procedure is a squeeze-out bid in the sense of article 190 *quinquies* of the Consolidated Laws of Commercial Companies as detailed in Chapter IV of the Royal Decree of 8 November 1989. Article 190 *quinquies* of the Consolidated Laws of Commercial Companies provides that each natural or legal person who, alone or jointly, holds 95 per cent of the voting securities of a company limited by shares may acquire all the securities of such company. At the end of the proceedings any securities that have not been offered, whether or not the holder thereof appeared, will be considered transmitted by operation of law to that person, on payment of the purchase price into the *Caisse de Dépôt et Consignation* (which is a state-owned depository institution). Securities issued to the bearer which have not been offered will be converted into registered shares by a resolution of the general meeting. At the end of the purchase offer, the company will no longer be considered a company which makes or has made a public offer of its securities unless bonds issued by such company are still publicly held.

The conditions of the bid are detailed in article 45 of the Royal Decree of 8 November 1989. The bid must comply with the provisions of Chapter IV of the Royal Decree of 8 November 1989, but also with Chapter I of this Decree. Therefore, as far as the procedure is concerned, the squeeze-out bid is very similar to a voluntary take-over bid. Of course, the result will differ. The result of a squeeze-out bid will be that the minority shareholders lose their proprietary rights in the company and the bidder will have full, 100 per cent control over the company. The minority shareholders cannot refuse to sell their shares. The aim of a mere take-over bid is to have control of the public company, but not 100 per cent of the shares. In the case of a voluntary take-over bid, the minority shareholders have the possibility of refusing the offer and not selling their voting shares at the proposed price.

The most important element of the squeeze-out bid, and the element by means of which the squeeze-out bid differs from the take-over bid, is the price and the setting of the price. As the minority shareholder cannot refuse to sell its shares, the setting of a correct price is very important. The Royal Decree provides that with regard to the price, the

interests of the investors should be safeguarded.[72] The following measures will be necessary to implement this rule:

- An independent expert must make a report on the relevancy of the valuation rules used by the bidder to evaluate the target company and to justify the price, and the expert should indicate whether the price safeguards the interests of the investors and the equal treatment of the investors;
- The managing board of the target company should give its advice;
- There is a procedure installed whereby the minority shareholders can offer comments; and
- The *Commission Bancaire et Financière* controls the regularity of the offer and the quality of the information given by the offeror.

The second possible procedure is a voluntary take-over bid (in the sense of Chapter II of the Royal Decree of 8 November 1989), followed by a squeeze-out bid. A person making a voluntary take-over bid on the shares of a company whose shares are distributed in public (a public company) can retain in the prospectus the possibility of reopening the bid and of opening a squeeze-out bid when as a result of the (first) bid he holds 95 per cent or more of the voting shares. The price of the squeeze-out bid is the same as the price of the voluntary take-over bid. This price is viewed as correct because the market has evaluated it as a correct price.

The third possible procedure is a squeeze-out bid which follows the acquisition of control over a company, whether through a public bid or a maintenance of the quotation price. In fact, two different hypotheses of squeeze-out are possible in the case of an acquisition of control, namely:

- The offeror has the possibility of giving the mandatory take-over bid the legal consequences of a squeeze-out bid when, as a result of the acquisition of control, he already holds at least 95 per cent of the voting shares of the company; and
- When, as a result of the acquisition of the control, he does not (yet) hold 95 per cent of the voting shares, he has the possibility of letting the mandatory take-over bid be followed by a squeeze-out bid.[73]

Insider Trading

Applicable Legislation and Regulation

Applicable Legislation

The prohibition of the use of privileged price-sensitive information with regard to securities traded on a stock exchange was introduced in Belgium in 1989 with the insertion of

72 Royal Decree of 8 November 1989, art 45, s 4.

73 The price will then be equal to the price of the mandatory take-over bid, which will, for the same reasons as in the case of a squeeze-out bid which follows a voluntary take-over bid, be regarded as a correct market price.

article 509 *quater* in the Penal Code. The rules were reformed by the Law of 4 December 1990 on Financial Transactions and Financial Markets and again by the Law of 6 April 1995 on Secondary Markets, the Status and Supervision of Investment Firms, Intermediaries, and Advisers. The insider dealing legislation which is currently in force is based on the Council Directive of 13 November 1989, Co-ordinating Regulations on Insider Dealing.[74]

Definitions and Regulation

The Belgian definition of 'inside information'[75] is based on the definition of article 1 of the EC Directive: 'inside information' means information which has not been made public which is sufficiently clear relating to one or several issuers of securities or other financial instruments, and which, if it were made public, would be likely to have a significant effect on the price of the securities or other financial instruments in question. The notion of insider information therefore depends to a large extent on the price sensitivity the information would possess if it were disclosed. The information must be sufficiently precise and certain.

Under Belgian law, there is an exception for holding companies. Information which holding companies have on their subsidiaries on the basis of their role in the management of these subsidiaries — even price-sensitive information — will not be considered inside information, provided that such information is not subject to mandatory disclosure.

Belgian law makes a further distinction between primary insiders and secondary insiders, so-called 'tippees'. 'Primary insiders' are persons who by virtue of their membership in the management or supervisory bodies of the company or by virtue of their holding in the capital of the issuer, or because they have access to such information by virtue of the exercise of their employment, profession, or duties, possess information of which they reasonably should be aware that such information constitutes inside information. It is prohibited for primary insiders either for their own account or for the account of third parties to buy or sell securities or other financial instruments to which such information relates. The primary insiders may not divulge the inside information, except in the course of their normal professional activities, nor may they on the basis of the inside information propose or recommend a third party transaction with respect to such instruments to which the information relates.

A 'secondary insider' is a person who has received the inside information as a tip. The same restriction on the use of inside information exists for secondary as for primary insiders.[76]

Conflict of Law Aspects

Article 5 of the Council Directive of 13 November 1989 provides that each member state of the EU must apply its insider dealing regulations at least to actions undertaken within its territory to the extent that the transferable securities concerned are admitted to trading

74 European Community Directive 89/592/EEC.
75 Law of 4 December 1990, art 181.
76 Law of 4 December 1990, art 184.

on a market of an EU member state. In any event, each member state must regard a transaction as carried out within its territory if it is carried out on a regulated market situated or operating within its territory. In application of article 5, the Belgian legislator has provided that the Belgian insider dealing regulations[77] apply to acts accomplished in Belgium or abroad when they relate to securities or other financial instruments which have been admitted in Belgium to the listing of a Stock Exchange (or are traded on a market designated by the King; NASDAQ is such a market).

Furthermore, the Belgian insider dealing rules also are applicable to acts accomplished in Belgium relative to securities or other financial instruments which have been admitted for trading on a regulated market which is controlled by an entity recognised by the authority, which functions on a regular basis, which is open to the public, and which is situated or operational in a member state of the EU.

Powers of Market Authority

For the Brussels Stock Exchange, the relevant authorities will be the Managing Committee and the *Commission Bancaire et Financière*, which are responsible for monitoring compliance with the insider dealing rules, though without taking anything away from the competence of the judicial authorities.

The market authority may acquire access to all documents and copy all documents it considers relevant for the investigation of insider trading. It has the right to obtain any relevant information and can question any officer or employee of a financial intermediary (member of the exchange). It can ask any question that in its opinion is reasonable and useful. It may visit the financial intermediary, on whose premises it must be granted full access to all documents and records. It may consult with other market authorities and exchange information. It may adopt measures of intervention to stop the activities which go against the rules of the relevant market.

The relevant market authority has the same powers over foreign member institutions active on the market that it has over Belgian members. The relevant market authority can take disciplinary sanctions against the members of the exchange who do not co-operate in an investigation on insider dealing (fines, suspension of membership, limitation of activities, and revocation of authorisation). However, the market authority has no direct power over investors; it can only transmit its finding to the judicial authorities who, on the basis of the factual information given by the market authority, can institute proceedings against the investors committing the criminal offence of insider trading. In this respect, no difference should be made between Belgian and foreign investors.

Judicial Proceedings

The relevant market authority does not have the authority to judge the investor charged with insider dealing. This belongs to the competence of the criminal courts. The judicial

77 Law of 4 December 1990, arts 182–184.

authorities can demand from the market authority and the *Commission Bancaire et Financière* any information which it deems necessary for building its criminal case.[78] At any time, they may demand the advice of the *Commission Bancaire et Financière*, which normally must then be given within one month. The *Commission Bancaire et Financière* also can give advice to foreign judicial authorities. The *Commission Bancaire et Financière* may, however, refuse to give any information to a foreign judicial authority if such information would jeopardise Belgian sovereignty, safety, or public order.

An investor who has been found guilty of insider trading can be imprisoned for a maximum period of one year and can be heavily fined. Appeal against a decision in first instance of the criminal courts is possible.

78 Law of 4 December 1990, art 187.

Brazil

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Brazil

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Introduction

In General

The main laws applied to the Brazilian securities market are:

- Law Number 6.385 of 7 December 1976 (the 'Securities Law'), as amended by Law Number 10.303 of 31 October 2001, which disciplines the securities market and creates the regulatory entity, the Securities and Exchange Commission (CVM); and
- Law Number 6.404 of 15 December 1976 (the 'Corporation Law'), as amended by Law Number 9.457 of 5 May 1997 and Law Number 10.303/01, which governs corporations.

The CVM functions under the National Monetary Council (CMN) and at the same hierarchical level of the Central Bank of Brazil (Bacen), which form part of the Brazilian Financial System:[1] All these entities are subject to the Constitution and the laws issued by the National Congress, and other rules with the same legal power, such as provisional measures, enacted directly by the President of the Republic.

Due to the agility, complexity, and constant evolution of the Brazilian Financial System, it would be impossible for all related regulation to pass through the parliamentary process. Therefore, Law Number 4.595 of 31 December 1964 created and gave normative powers to the CMN, which is the highest regulatory entity within the Brazilian Financial System. The rules issue by the CMN, ie, Resolutions (*Resoluçoes*), must be complied with by the members of the Financial System, including Bacen and the CVM.

The CVM has the power to issue complementary rules to the laws and CMN Resolutions. The most relevant rules issued by the CVM are Instructions and Deliberations. This system, as it can be observed in the diagram below, is complemented by the self-regulatory power of Stock and Futures Exchanges.

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1 The Brazilian Financial System is composed of the CMN, the Private Insurances National Council (CNSP), and the Complementary Pension Management Council (CGPC). Both the CVM and Bacen are linked to the CMN. The regulatory supervising entities linked to the CNSP and CGPC are, respectively, the Private Insurance Superintendency (Susep) and the Complementary Pension Secretariat (SPC).

Regulatory Structure of the Brazilian Financial System

Role of the National Monetary Council

The CMN is the head body of the Brazilian Financial System, has normative functions, and:

- Defines the policy to be observed in the organisation and operation of the securities market;
- Regulates the use of credit within the market;
- Establishes the general guidelines to be observed by the CVM in the performance of its duties;
- Defines the activities of the CVM to be performed in coordination with Bacen; and
- Approves the staff and personnel regulation of the CVM and establish the remuneration of the chairman, commissioners, holders of trusted positions, and other employees.

Bacen

Bacen, created by Law Number 4.595 of 31 December 1964, is an autonomous federal institution which ensures the purchasing power stability of the Brazilian currency (the

Real) and the integrity of the financial system, and exclusively prints and issues currency. Its functions include those to:

- Formulate monetary policy through the use of National Treasury bonds;
- Establish the reference rate for one-day committed operations, known as the SELIC rate;[2]
- Control the credit operations of institutions that comprise the financial system.
- Formulate, execute, and supervise the currency exchange policy and financial relations policy with foreign countries;
- Inspect commercial banks;
- Issue paper money;
- Execute current services to supply money needed to economic activities;
- Control inflation;
- Control the expansion of currency, credit, and interest rates;
- Operate in the open market;
- Announce decisions made by the CMN;
- Keep gold and foreign currency assets for operation in currency exchange markets to maintain the parity of the Brazilian currency;
- Manage Brazilian international reserves;
- Assure the liquidity and solvency of financial institutions; and
- Authorise the functioning of financial institutions.

Integration of the National Monetary Council and the Securities and Exchange Commission

The CMN and CVM are to perform their respective duties, as provided for under the Securities Law, in order to:

- Stimulate the creation of savings and their investment in securities;
- Promote the expansion and the regular and efficient operation of the stock markets, and stimulate permanent investments in the capital stock of publicly held corporations controlled by private Brazilian capital;
- Guarantee the efficient and correct operation of stock markets and over-the-counter markets;
- Protect securities holders and market investors against the irregular issue of securities, illegal acts of officers and controlling shareholders of publicly held corporations, or managers of securities portfolios, and the use of relevant information not disclosed to the market;

2 The Monetary Policy Committee (Copom) is the primary monetary policy-making body of Bacen and it is responsible for establishing the target for the SELIC rate, the Bacen's principal monetary policy instrument, which is the average interest rate on overnight inter-bank loans collateralised by government bonds that are registered with and traded on the Settlement and Custody Special System (SELIC).

- Avoid or prevent fraud or manipulation intended to create artificial conditions of supply, demand, or price of securities traded on the market;
- Guarantee public access to information on the securities traded and the corporations issuing them;
- Guarantee the observance of equitable business practice on the securities market; and
- Guarantee compliance with the conditions established by the CMN regarding use of credit.

Securities Exchange Commission

The CVM is an autonomous federal institution linked to the Ministry of Finance, but not under hierarchical subordination, created by the Securities Law to inspect and develop the securities market in Brazil. Its role is to:

- Regulate the matters expressly provided for in the Securities Law and in the Corporation Law, with due regard for the policies defined by the CMN;
- Administer the registrations instituted by the Securities Law;
- Control the activities and services of the securities market, and disclose information relating to the market, individuals participating in it, and the securities traded thereon;
- Propose to the CMN establishment of maximum limits for prices, commissions, and fees charged by market brokers; and
- Control publicly held corporations.

International Activities of the Securities Exchange Commission

The CVM has an International Affairs Office, whose competence consists of management of the execution of several Agreements of Technical Cooperation and Exchange of Information (Memorandum of Understanding, MoU) signed by the CVM and other commissions, with the objective of strengthening mutual cooperation and supervision, and representation of the CVM before international institutions related to the regulating agencies or other operating organs in the securities area.

The CVM has endorsed several international cooperation agreements, both bilateral and multilateral. The multilateral agreements endorsed by the CVM are:

- The Windsor Declaration (1995);
- The Boca Raton Declaration (1996); and
- The International Organisation of Securities Commissions (IOSCO) Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (May 2002).

Securities Market

The following activities are governed by and controlled by the CVM in accordance with the Securities Law:

- Issuing and distribution of securities on the market;

- Trading and intermediation on the securities market;
- Trading and intermediation in the derivatives market;
- Organisation and operation of stock exchanges;
- Organisation and operation of commodities and futures exchanges;
- Management of securities portfolios and custody of securities;
- Auditing of publicly held corporations; and
- Services of securities consultants and advisors.

For the purposes of the Securities Law, the term 'securities' comprises:

- Shares, debentures, and subscription bonuses;
- Coupons, rights, subscription receipts, and split certificates relating to the securities indicated above;
- Certificates of deposit of securities;
- Debenture certificates;
- Shares of mutual funds investing in securities and shares of investment clubs investing in any type of assets;
- Commercial paper;
- Futures, options, and other derivatives agreements whose underlying assets are securities;
- Other derivatives agreements regardless of the respective underlying assets; and
- When publicly offered, any other collective investment instrument or agreement that creates the right of participation on profits or remuneration, including as a result of the rendering of services, and whose profits derive from the efforts of the entrepreneur or from the efforts of third parties.

All securities are subject to the supervision and control of the CVM. Federal, state, or municipal government bonds and negotiable instruments guaranteed by a financial institution (other than debentures) are not deemed to be 'securities' within this context and are subject to the supervision and control of Bacen and not of the CVM. The issuer of the securities, as well as the managers and controlling parties, are subject to the rules established by the Securities Law with respect to publicly held corporations. The CVM will be responsible for issuing regulations to give effect to the provisions of the Securities Law, being empowered to:

- Require that the issuers be incorporated as corporations;
- Require that the financial statements of the issuers, or information concerning the applicable project, be audited by an independent auditor registered with the CVM;
- Waive the requirement of participation of a company comprising the Securities Distribution System in a public offering of securities; and
- Establish standard clauses and conditions to be adopted in the investment instruments and agreements to be traded in Stock Exchanges or in organised or non-organised over-the-counter markets and refuse the trading of any issue that fails to meet such standards.

Securities Distribution System

The Securities Distribution System in Brazil comprises the following participants:

- Financial institutions and other corporations engaged in the activity of distributing securities issues as agents of the issuing corporation or for their own accounts, underwriting or purchasing the issue in order to place it on the market;
- Corporations engaged in the activity of purchasing securities available on the market, in order to resell them for their own accounts;
- Corporations and independent agents engaged in intermediation activities in the trading of securities on stock exchanges or the over-the-counter market;
- Stock exchanges;
- Organised over-the-counter markets;
- Commodities brokers, special operators, and the commodities and futures exchanges; and
- Securities clearing and settlement entities.

The CVM will define the types and kinds of financial institution which may perform activities in the securities market, as well as the transactions it may carry and the services it may provide on this market and the specialisation of transactions or services to be observed by the corporations in the market, as well as the conditions under which they may accumulate their types and kinds of transactions and services.

With respect to financial institutions and other corporations authorised to perform simultaneously transactions or services on the securities market and on markets subject to Bacen's supervision, the duties of the CVM will be limited to the activities governed by Securities Law and will be exercised taking into account the duties of Bacen. The CMN will regulate these activities, ensuring the coordination of services between Bacen and the CVM. The following activities will require prior authorisation of the CVM:

- Distribution of securities issues on the market;
- Purchase of securities for resale, for their own accounts;
- Intermediation or brokerage on operations involving titles; and
- Clearing and settlement on operations involving titles.[3]

The stock exchanges, futures exchanges, organised over-the-counter market entities, and securities clearing and settlement entities have administrative and financial autonomy and must operate under the supervision of the CVM. Stock exchanges, futures exchanges, over-the-counter market entities, and securities clearing entities, as ancillary entities of the CVM, will be required to supervise their respective members and the securities transactions carried out by them. In this regard, the CVM will govern:

- The conditions for obtaining the authorisation or registration required for carrying out any of the above-mentioned activities and the respective administrative procedures;

3 Only independent agents and corporations registered with the CVM may engage in securities mediation or brokerage activities outside the Stock Exchange.

- The conditions regarding the good reputation, financial capacity, and technical qualifications for corporation officers and any other individuals participating in the securities market;
- The conditions regarding the constitution and dissolution of Stock Exchanges, entities of the organised over-the-counter market, as well as entities of clearing and settlement, their legal constitution, and the appointment of members of their boards;
- The exercise of disciplinary authority by the Stock Exchanges and organised over-the-counter market, concerning the trading of securities, and by entities of clearing and settlement over their members, the imposition of penalties, and cases of exclusion;
- The number of broker-dealers which may be members of a Stock Exchange, requirements or conditions for admission regarding credibility, financial capacity, and technical qualifications of their managers, and representation on Stock Exchange floor trading;
- The management of Stock Exchanges, entities of the organised over-the-counter market, and entities of clearing and settlement; fees, commissions, and any other amount charged by the Stock Exchanges and entities of clearing and settlement or their members;
- The conditions regarding forward operations; and
- The conditions for constitution and dissolution of the futures exchanges, their legal form, administration institutions, and their components.

Furthermore, the CVM will define:

- The types of operations Stock Exchanges and over-the-counter markets may engage in, the methods and practices to be observed on the market, and the accountability of intermediaries in operations;
- The pattern of artificial conditions of supply, demand, and price of securities, or of price manipulation and fraudulent operations and inequitable practices in securities distribution or intermediation; and
- The rules applicable to the record of operations, to be kept by the entities that compose the Securities Distribution System.

Trading of Securities

No public issue of securities may be distributed on the market without prior registration with the CVM. The CVM is empowered to enact rules governing the enforcement of the provisions of issue and distribution of securities. The sale, the promise to sell, the offer to sell or underwrite, and the acceptance of an order to sell or underwrite securities, when practised by an issuing corporation, its founders, or persons considered equivalent to such, will be considered acts of distribution. The following will be considered equivalent to an issuing corporation:

- The controlling shareholder and any entities controlled by the corporation;
- The co-obligor named in the securities;
- The financial institutions and other corporations engaged in the activity of distributing securities issues as agents of the issuing corporation or for their own accounts, underwriting, or purchasing the issue in order to place it on the market; and

- Anyone who has underwritten securities of an issue, or has purchased them from the issuing corporation for the purpose of placing them on the market.

A public issue is characterised by the use of sales or underwriting lists or bulletins, leaflets, prospectuses (brochures), or advertisements directed at the public; the search for underwriters or purchasers of securities by employees, agents, or brokers; and trading carried out in a store, office, or establishment open to the public, or by using public communication services. A public issue may only be placed on the market through the Securities Distribution System, and the CVM may require the participation of a financial institution.

The CVM may define other situations which, for registration purposes, constitute a public issuing, as well as cases in which such registration may be dispensed, bearing in mind the interests of the investing public; and establish registration procedures and specify the information to be supplied with the application, including that with respect to:

- The issuing corporation, the business, or activities it is or intends to be engaged in, its financial and economic situation, management, and principal shareholders;
- The characteristics of the issuance and the use of the proceeds thereof;
- The seller of the securities; and
- The parties participating in the distribution, their remuneration, and their relationship with the issuing corporation or the seller.

The CVM may condition such registration to a minimum capital of the issuing corporation and a minimum amount of issue, as well as to the disclosure of any information it may deem necessary to protect the interests of the investing public. The registration application will be accompanied by prospectuses and any other documents to be published or distributed, for the offering, advertising, or promotion of an issue. The CVM will order the suspension of any issuance or distribution which is not being made in accordance with the applicable provisions mentioned herein, particularly when:

- The issuance has been deemed as fraudulent or illegal, even after it has been registered; or
- The offer, release, promotion, or announcement of the securities is being made under conditions other than those contained in the registration, or with false, fraudulent, or substantially inaccurate information.

Negotiation on the Stock Exchange and the Over-the-Counter Market

In addition to the registration for public issue and distribution of securities, the CVM will maintain registration for trading on the Stock Exchange and registration for trading on the over-the-counter market, organised or not. Only the securities issued by a corporation registered in accordance with the law may be traded on the Stock Exchange and the over-the-counter market.

The registration for public issue and distribution of securities with the CVM implies the registration for the over-the-counter market, but not for a stock exchange or an organised over-the-counter market entity. The activities carried out with the participation of the corporations or professionals listed below, or in their premises, excluding those made on

Stock Exchanges or on systems administered by entities of the organised over-the-counter market, are considered as being on the non-organised over-the-counter market. The corporations or professionals referred to herein are the following:

- Financial institutions and other corporations engaged in the activity of distributing securities issues as agents of the issuing corporation or for their own accounts, underwriting, or purchasing the issue in order to place it on the market;
- Corporations engaged in the activity of purchasing securities available on the market, in order to resell them for their own account; and
- Corporations and independent agents engaged in intermediation activities in the trading of securities, on Stock Exchanges or the over-the-counter market.

Each stock exchange or entity of the organised over-the-counter market may lay down its own requirements for accepting securities for trading on their floors or systems, once prior approval has been given by the CVM. The organised over-the-counter market will be administrated by entities which operate after previous authorisation of the CVM, which will issue general rules regarding:

- The conditions for their constitution and dissolution, their legal form, and the appointment of members of their boards;
- The exercise of disciplinary authority over their members, the imposition of penalties, and cases of exclusion;
- The requirements or conditions for admission regarding credibility, financial capacity, and technical qualifications of the managers and officers of their members; and
- The management of the entities, fees, commissions, and any other amount charged by the entities or their members, as the case may be.

The CVM will issue regulations specifying:

- The cases in which the registration may be dispensed with, refused, suspended, or cancelled;
- The information and documents which must be submitted by the corporation for obtaining registration and the respective procedures; and
- The cases in which the securities may be simultaneously negotiated on a stock exchange and on the over-the-counter market, organised or not. The CVM will issue rules regarding the nature of the minimum information and its periodical presentation by any party who has access to relevant information.

CVM Instruction Number 461 of 23 October 2007, amended by CVM Instruction Number 468 of 18 April 2008, governs the securities regulated markets in Brazil and the incorporation, organisation, operation, and winding-up of stock exchanges, commodities and futures exchanges, and organised and non-organised over-the-counter markets. The only relevant Brazilian exchange is the BM&FBOVESPA SA (Securities, Commodities and Futures Exchange), which is responsible for all the organised markets (stocks, commodities and futures, and over-the-counter market).

An organised market of securities will be considered by the CVM as an organised stock exchange or an organised over-the-counter market, depending on:

- The existence of a system or environment for registration of operations previously effected;
- The rules adopted in their transaction environments or systems for pricing, as described below, in the case of a stock exchange or of an organised over-the-counter market;
- The possibility of direct participation in the market, with no intervention of any intermediary;
- The possibility of postponing the disclosure of information on the transactions carried out;
- The volume traded in their environments and systems; and
- The investor audience targeted by the market.

Stock Exchange markets are those that:

- Trade regularly as central and multilateral trading systems that enable the matching and the interaction of offers for the purchase and sale of securities; or
- Allow the transaction of business, whether subject or not to the interference of other persons authorised to trade in the market, where a counterpart is a market maker that undertakes the obligation of placement of firm offers for purchase and sale, provided that (a) the participation of a market maker be regulated by the Stock Exchange, pursuant to the specific regulation of the CVM for market makers, and inspected by the Self-Regulation Department, (b) the Stock Exchange establishes maximum limits for the difference between the purchase and sale prices offered by the market maker; and (c) the interference of other persons authorised to trade in interval between the offers of purchase and sale, insofar as for the entire amount of that transaction.

A centralised and multilateral system is considered that system in which all the offers referring to the same security are directed to the same trading channel, and are exposed to the acceptance and competition by all the parties authorised to negotiate in the system. The Stock Exchange trading environment or system will have the characteristics, procedure, and trading rules previously established and disclosed that permanently enable:

- Regular, adequate, and efficient pricing;
- Prompt conduct, visibility, and registration of the transactions carried out; and
- Public dissemination of offers and business involving the assets traded thereon timely, comprehensively, and in sufficient details for the proper market information and pricing.

When the application involves a centralised and multilateral trading system, pricing will be made through interacting offers, in which preference is given to the one that represents the best price, with due regard for the chronological sequence of the offers entered into the system or trading environment, except in the cases of special trading procedures established by regulation. The Stock Exchange trading rules are intended to:

- Avoid or curb modes of fraud or manipulation designed to create artificial conditions of demand, offer, or price of securities traded in its environments;

- Ensure that all persons authorised to trade in their environments receive equal treatment, subject to the distinctions among the categories that may be specified in their bylaws and regulation;
- Avoid or curb non-equitable practices in its environments; and
- Establish the variations of prices and quantities offered, in its trading environment that is described as centralised and multilateral, which require the adoption of special trading procedures, as well as the operating procedures required when these variations are reached, subject to the minimum conditions established by the CVM in a specific regulation.

The organised over-the-counter market may trade in one or more of the following forms:

- As a centralised and multilateral trading system, and which enables the matching and interaction of offers for the purchase and sale of securities;
- By carrying out transactions, whether subject or not to the interference of other persons authorised to trade in the market that undertakes the obligation to place firm purchase and sale offers; or
- Through the registration of transactions previously carried out.

In an organised over-the-counter market, the trading or registration of transactions previously carried out may occur without the direct participation of an intermediary that is a member of the Securities Distribution System, provided that, in this case, according to the regulation procedures, the settlement of the transaction is contractually guaranteed by the managing entity of an organised over-the-counter market or, alternatively, directly by the parties to the transaction.

The trading environments and systems of an organised over-the-counter market must have the characteristics, procedures, and rules of negotiation previously established and disclosed that enable, on a permanent basis, a regular, adequate, and efficient pricing, as well as the prompt trading and registration of the transactions effected.

In the case of a centralised and multilateral trading system, pricing will be made by interacting offers, in which preference will be given to offers that represent the best price, according to the chronological order of entry of offers into the trading environment or system, except in the cases of special trading procedures provided for in a regulation.

In the case of a market in which the counter parties are market makers their action will be regulated and inspected by the managing entity of an organised over-the-counter market, pursuant to the terms of a specific CVM regulation for market makers. The rules of trade of the trading system of organised over-the-counter markets are intended to:

- Prevent or curb modes of fraud or manipulation designed to create artificial demand, offer, or price conditions of the securities traded in their environments;
- Ensure equal treatment to the persons authorised to trade in their environments, subject to the distinctions between categories that are stipulated in their bylaws and regulations; and
- Prevent or curb non-equitable practices in their environments.

The CVM may order the transformation of the organised over-the-counter market in a stock exchange, the change of operation procedures or rules of the organised over-the-counter market, or the amendment of waivers or special authorities granted by reason of actual characteristics of the market.

The operation and dissolution of organised markets of securities depends on the CVM's prior approval. Organised markets of securities may be divided into trading segments, taking the characteristics of the transactions carried out, the securities traded, the issuers thereof, the transaction system used, and the quantities traded into account. The operation and dissolution of the trading segment are contingent upon the CVM's prior consent, in writing. Every information or advertising material referring to organised markets of securities will mention, in an outstanding manner, its nature of either a stock exchange or an organised over-the-counter market.

Publicly Held Corporations

A corporation will be publicly held or closely held depending on whether its securities are accepted for trading in the securities market. Only securities issued by a corporation registered in the CVM may be traded in the securities market. No securities may be publicly distributed in the market without previous registration with the CVM.

The CVM may classify publicly held corporations in categories according to the types and classes of securities issued by it and traded in the market, and will specify the regulations for publicly held companies applicable to each category.

The registration of a publicly held corporation for shares to be traded in the market may only be cancelled if the corporation that issued the shares, the majority shareholder, or the controlling corporation directly or indirectly makes a public offering to acquire the entirety of outstanding shares for a fair price, at least equal to the appraised worth of the corporation, calculated based on one or more of the following criteria:

- Net assets appraised at market value;
- Discounted cash flow;
- Comparison by multiples;
- Share quotation in the securities market; or
- Another criteria adopted by the CVM.

If less than five per cent of all shares issued by the corporation are outstanding after the expiration of the term for public offering established by the regulation issued by the CVM, the general meeting may decide to redeem these shares for the amount of the offer, as long as it deposits the redemption amount at a bank authorised by the CVM.

If the majority shareholder or the controlling corporation acquires shares of a publicly held corporation under its control, and these shares directly or indirectly increase their interest in a certain class of shares in a way that hinders the market liquidity of the remaining shares, they will be required to make a public offering for a price determined for the acquisition of all shares remaining in the market, according to the general rules issued by the CVM.

Shareholders holding at least 10 per cent of outstanding shares of a publicly held corporation may request the officers to call a special general meeting with holders of outstanding shares in order to determine a new appraisal, based on the same or on different criteria from those originally adopted, for purposes of determining the valuation of the company.

The request must be delivered within 15 days from the announcement of the price attributed to the public offer, accompanied by a justification and evidence of inadequacy or misuse of the calculation methodology or the valuation criteria. The shareholders holding at least 10 per cent of outstanding shares may call the applicable meeting if the officers fail to do so within eight days of the date of the request. Outstanding shares include all issued shares of a publicly held corporation less the shares held by controlling shareholders, officers and directors, and treasury shares.

Those shareholders who request a new valuation and those shareholders who vote in favour of the new valuation will reimburse the company of all costs incurred with the new valuation if the new valuation amount is lower than or equal to the initial amount of the public offer. Therefore, a corporation will be considered to be as publicly held when its securities are accepted for trading on the Stock Exchange or over-the-counter market. the CVM will issue regulations applicable to publicly held corporations concerning:

- The kind of information which must be supplied and how often;
- The management report and financial statements;
- The purchase of shares issued by the corporation itself and the disposal of treasury shares;
- The accounting standards and reports and opinions of independent auditors;
- The information supplied by officers, members of the statutory audit committee, and controlling and small shareholders relating to the purchase, exchange, or sale of securities issued by the corporation and by controlled or parent corporations;
- The disclosure of resolutions of the general meeting and the corporation's management bodies, or of relevant events occurring in its operations which may considerably influence the decisions of investors to buy or sell securities issued by the corporation;
- The holding, by publicly held corporations with shares traded on the Stock Exchange or organised over-the-counter market, of annual meetings with their shareholders and securities market participants, in the city where most of the operations involving the corporation's securities took place the year before, in order to disclose their financial situation and projected figures, and to answer requests for clarifications; and
- Other topics envisaged by law.

Portfolio Management and Custody of Securities

The professional management of securities portfolios of other individuals is subject to prior authorisation of the CVM. This will apply to the professional management of funds and securities delivered to the administrator, with authorisation for such administrator to buy or sell securities on behalf of the principal. The CVM will establish the rules to be observed by the managers and their remuneration, proposing to the CMN maximum limits for such remuneration.

The CVM will authorise securities custody activities, to be carried out exclusively by financial institutions and entities of clearing and settlement. Custody of securities is defined as the activities of depositing securities for safekeeping, receiving dividends or stock dividends, redemption, amortisation, or reimbursement, and exercise of underwriting rights, without the depositary having powers to transfer securities deposited or reinvest amounts received, except upon the express authorisation of the depositor in each instance.

The portfolio manager and the custodian may not exercise the voting rights of the shares under their management or custody, except in the event of a mandate for a period of no longer than one year.

Independent Auditors, Securities Analysts, and Consultants

Only audit firms or independent auditors which are registered with the CVM may audit, for the purposes of the Securities Law, the financial statements of publicly held corporations and institutions, companies, or other entities which compose the Securities Distribution System. The CVM will determine the conditions for registration and the respective procedures, and will define the cases in which such registration may be denied, suspended, or cancelled. CVM Instruction Number 308 of 14 May 1999 regulates the registration procedure and activities performance of independent auditors in the securities market.

Independent auditors or auditing firms will be subject to civil liability for any losses caused to third parties as a result of fraud or fault in the exercise of their functions.[4] Independent auditors of auditing firms are administratively responsible, before Bacen, for the acts or omissions when auditing financial institutions and other entities that are authorised to function by Bacen.[5] In this case, Bacen is responsible for enforcing on the offenders the penalties provided for in the Securities Law. The CVM may establish regulations regarding the activities of securities analysts and consultants.

International Financial Reporting Standards

Law Number 11.638 of 28 December 2007 amends and revokes certain provisions of the Corporation Law and the Securities Law, and extends to large companies the provisions regarding the preparation and disclosure of financial statements. The Law introduces in Brazil the international accounting standards, ie, the pronouncements issued by the International Accounting Standards Board (IASB), the so-called International Financial Reporting Standards (IFRS).

With the adoption of the IFRS, the Brazilian cost is reduced, mainly for the foreign investor who was obliged to maintain an exclusive department for the preparation and analysis of the financial statements of the companies established in Brazil. According to the rules, assets and liabilities of the Brazilian companies will be registered by their market value and no longer for their acquisition cost. This will assure more reality in the examination of the solvency conditions of the companies.

4 Securities Law, art 26, para 2.
5 Securities Law, art 26, para 3.

As a result of Law Number 11.638/07, Brazilian publicly held corporations must regularly disclose cash flow and aggregate value statements. This will enable investors to better know the company's cash flow. However, any closely held corporation with a net worth value of less than R $2 million on the date of the balance sheet will not be obliged to prepare and publish a cash flow statement.

The Law applies not only to the publicly held corporations, but also to the closely held companies, even those that are not incorporated in the form of corporations (*sociedades anônimas*), if they are deemed to be large companies. For the purpose of Law Number 11.638/07, 'large company' is the company or group of companies under common control that has, in the precedent fiscal year, total assets above the amount of R $240 million or an annual gross revenue exceeding R $300 million. Therefore, a limited liability company (*sociedade empresária limitada*) or any other type of legal entity which complies with such requirements also will be considered a large company. All large companies, regardless of their corporate form, must follow the new rules about bookkeeping and preparation of financial statements and hire an independent auditor duly registered with the CVM to audit such financial statements. Law Number 11.638 came into force on 1 January 2009.

CVM Instruction Number 457 of 13 July 2007, which governs the preparation and disclosure of consolidated financial statements according to the IFRS as issued by the IASB, was enacted before Law Number 11.638/07 and determines that publicly held corporations will present their consolidated financial statements complying with such requirement starting from reporting periods ending in 2010. This also is applied to the consolidated financial statements of the previous fiscal year presented for comparison purposes.

Until the reporting period ending in 2009, publicly held corporations may, optionally, present their consolidated financial statements in accordance with the IFRS as issued by the IASB, in lieu of Brazilian accounting standards. As a result of adopting this option, and in addition to the other applicable provisions required by the CVM, the explanatory notes to the consolidated financial statements will include a reconciliation illustrating the effects of events that produced differences between the amounts of shareholders' equity and of profit or loss of the parent company, comparing such amounts with those of the consolidated equity and of profit or loss. Those companies that adopt this optional procedure are not obliged to present, for comparison purposes, the consolidated financial statements of the previous reporting period prepared under the Brazilian accounting standards. Independent auditors must issue an opinion about the consolidated financial statements prepared according to the IFRS, as well as about the explanatory note referred to above.

Investment Funds

The mutual industry fund in Brazil is highly regulated and is subject to the control and supervision of the CVM.[6] Under the current regulations, 'investment fund' is the gathering

6 The current basic regulations on the incorporation, administration, operation, and disclosure of information of investment funds in Brazil have been approved by CVM Instruction Number 409 of 18 August 2004 and amended.

of capital, in the form of a condominium, aimed at the investment in shares and stock and any other kind of instrument available in the financial and capital markets. Therefore, unlike other jurisdictions, a Brazilian fund is a condominium and not a legal entity.

Management of the fund's portfolio is the professional management, as established in the regulation, of its securities, developed by an individual or a legal entity registered in the administrator of the securities portfolio by the CVM, having the manager powers to trade, in the name of the investment fund, these securities.

Market Makers

A 'market maker' is a person, brokerage, dealer, bank, or institution that stands ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price. Market makers play an important role in maintaining liquidity and guaranteeing price reference for the particular securities for which they are registered to trade.

The role of market maker at BM&FBOVESPA may be performed by trading members, non-member-broker dealers, investment banks, and multi-service banks that manage investment portfolios. There are two types of market maker:

- The independent market maker — The market maker has links neither with the issuing corporation nor with its holders/major shareholders, being committed to making the market without ties with the company, holding group, or shareholders; and
- The contracted market maker — The market maker signs an agreement with the issuing corporation, holding group, affiliates, or any shareholder to make the market for a given security. In this case, remuneration is freely agreed between parts.

This possibility is highly important in the Brazilian scenario, where the number of assets available is generally low. Therefore, the issuing corporation is allowed to take part in this process to improve the liquidity of its securities in the market.

Foreign Exchanges

CVM Instruction Number 461/07 introduced the conditions a foreign exchange has to comply with to offer to Brazilian intermediaries access to its electronic trading venues. The foreign stock exchange willing to establish the access screens to their trading systems in Brazil, in the institutions that are members of the Securities Distribution System, must obtain CVM prior approval, to be granted, provided that the candidate for CVM authorisation:

- Is recognised as a stock exchange and is duly authorised to trade as such in its country of origin;
- Is subject to the supervision of the regulatory authority of the capital market of its country of origin, with which the CVM maintains an arrangement or agreement for international cooperation or which is a signatory to the Multilateral Memorandum of Understanding of the International Organisation of Securities; and

- The requisites required for authorisation and operation of stock exchanges in the applicant's country of origin are substantially equivalent to those provided for in the CVM regulations.

The CVM authorisation depends on the accessibility, sufficiency, and quality of the information concerning the assets negotiated in a foreign Stock Exchange, as well as of their issuers, if applicable. In confirming the requisites specified in the general provisions, the CVM will consider, among other characteristics considered relevant, if it is a derivative contract. The underlying asset of which has homogeneous characteristics is produced and quoted on international level, and the accounting standard according to which the financial statements of issuers of the assets traded. The authorisation for installation of a trading screen will exempt the issuers and securities traded thereon from registration, and the authorisation may be limited to specific assets and issuers or to some trading segments.

Enforcement Attributions of the CVM

To enforce the Securities Law, the CVM may:

- Examine and extract examples of accounting records, books or documents, including electronic programmes, magnetic and optical files, as well as any other files, and the paperwork of independent auditors (all of which must be organised and preserved intact for at least five years) regarding (a) individuals and corporations pertaining to the Securities Distribution System; (b) publicly held corporations and other issuers of securities and, whenever there are indicia of illegal activities, of the corresponding controlling and controlled companies, affiliated companies, and companies under common control; (c) investment funds and corporations; (d) securities portfolios and custodians; (e) independent auditors; (f) securities analysts and consultants; and (g) any other individuals or legal entities whenever they participate in any irregularities, which will be investigated according to the fifth item below, to ensure the non-occurrence of any illegal acts and inequitable acts;
- Issue subpoenas requesting information or clarifications to the persons indicated above, under penalty of a fine, without prejudice to the other penalties set forth below;
- Request information from any government agency, autonomous institution, or public corporation;
- Require publicly held corporations to republish their financial statements, reports, or information released, duly corrected or amended;
- Investigate, through administrative proceedings, illegal acts and inequitable practices of managers, members of the finance committee, and shareholders of publicly held corporations, intermediaries, and other market participants; and
- Apply penalties to any person committing the violations referred to in the previous item, regardless of civil or criminal responsibility.

In order to prevent or correct abnormal market situations, the CVM may:

- Suspend trading of securities or declare the recess of a Stock Exchange;
- Suspend or cancel the registrations provided for in the Securities Law;

- Publish information or recommendations for the purpose of informing or advising market participants; and
- Prohibit market participants, under the penalty of fine, from performing any activities it may specify which it considers to be harmful to normal market functioning.[7]

The determination of illegal acts and inequitable practices may be preceded by an investigation process, which will ensure the secrecy that the public interest demands, which is necessary for clearing the facts, and will be subject to the procedure established by the CVM.

In the investigation into the infringement of regulations under the securities market, the CVM will prioritise the violation of the severe nature of the law, which penalties will educate and prevent the individuals participating in the market. The CVM will have authority to investigate as well as to impose penalties on the violators of the laws under the market when:

- It causes damages to individuals living in Brazil, wherever the accident has happened; or
- Material actions or omissions have happened in Brazil.

The CVM may enter into agreements with similar entities in other countries, or with international entities, for assistance and cooperation in the investigations relating to infringement of regulations pertaining to the securities market occurring in Brazil and abroad. The CVM may refuse to provide the assistance referred to herein when the public interest needs to be preserved. This also will apply to information deemed confidential by law. The following penalties may be imposed by the CVM on the violators of any provision of the Securities Law, the Corporation Law, or CVM Resolutions, as well as any other legal provisions which are the CVM's responsibility to enforce:

- Warning;
- Fine;
- Suspension from duties of a director, administrator, or member of the fiscal council or statutory audit committee of a publicly held corporation, from an entity taking part in the Securities Distribution System, or from other bodies which require authorisation by, or registration with, the CVM;
- Temporary disqualification, up to a maximum period of 20 years, from occupying the posts mentioned in the previous item;
- Suspension of the authorisation or registration for the execution of the activities covered by the Securities Law;
- Cancellation of the registration or of the authorisation to carry out the activities covered by the Securities Law;

7 When the public interest demands, the CVM may disclose the establishment of any such procedure.

- Temporary prohibition, up to a maximum period of 20 years, from practising certain activities or transactions, to the entities that compose the Securities Distribution System or other entities that depend on authorisation by, or registration with, the CVM; and
- Temporary prohibition, for a maximum period of ten years, to operate, directly or indirectly, in one or more types of transaction in the securities market.

The fine may not exceed the larger of R $500,000, 50 per cent of the amount of the securities issuing or of the irregular operation, or three times the amount of the economic advantage gained or loss avoided due to the violation. Should the offence be repeated, the fines can be imposed and multiplied up to three times or, alternatively, the penalties provided above may be applied.

Crimes against Capital Markets

The Securities Law deals with crimes against capital markets and their respective penalties. To engage in fraudulent transactions or other deceitful action aiming at artificially changing the regular operation of the securities markets in stock exchanges and in futures and commodities exchanges, over-the-counter markets, or organised over-the-counter markets for the purpose of obtaining undue advantages or profits for oneself or others, or to cause damage to third parties, may result in imprisonment of one to eight years and a fine of up to three times the amount of the undue advantage obtained as a result of the crime.

To use relevant information not yet disclosed to the market, which one may know and which must remain confidential, so as to create undue advantages, for oneself or others, through the negotiation of securities, on one's behalf or on behalf of others may result in imprisonment of one to five years and a fine of up to three times the amount of the undue advantage obtained as a result of the crime.

To act in the securities market, whether free of charge or not, as an institution belonging to the distribution system, as a collective or individual portfolio manager, self-employed investment agent, independent auditor, securities analyst, or fiduciary agent or to exercise any position, profession, activity, or function without being so authorised by or registered at the applicable administrative authority, when required by law or regulation, may result in imprisonment of six months to two years and a fine.

The fines imposed on the crimes of market manipulation or misuse of privileged information will be applied according to the damage caused or the undue advantage obtained by the agent. In case of repeated offence, the fine may be tripled.

Anti-Money Laundering Regulations

CVM Instruction Number 463 of 8 January 2008 amends the rules dealing with crimes on money laundering or concealment of assets, rights, and valuables, originally established by CVM Instruction Number 301 of 16 April 1999, and sets forth the procedures to be observed for the follow-up of transactions entered into by people politically exposed. The

provisions incorporate in Brazilian regulations the FATF recommendations[8] designed to counter the use of the financial system by criminals and prevent terrorist financing and enable the supervision of the financial transactions made by people politically exposed.

The definition of 'people politically exposed' includes anyone who had a relevant public position, job, or function within the last five years in Brazil or in another country, foreign territory, and dependence, as well as his representatives, family members, and other persons of close relationship and comprises heads of state or of the government, high-level politicians, public servants, judges, or militaries and leaders of state-owned companies or of political parties, their first degree direct relatives, and the spouse, companion, or stepson or stepdaughter.

The main changes introduced by the CVM are related to the new obligations to be performed by the legal entities whose activity is the custody, issuance, distribution, settlement, negotiation, intermediation, or administration of securities, ie, banks, brokerage house companies, and fund managers, as well as entities which administer exchanges and the organised over-the-counter market.

These entities must keep registry of every transaction involving securities, regardless of its value, in order to permit the verification of the financial movement of each client, based on the defined criteria adopted by the institution in its control procedures, regarding the assets and financial situation shown in the client's registration form, considering the amounts paid to settle these transactions, the amounts or assets deposited as collateral in transactions carried out in future settlement markets, and the transfer of securities for the client's custody account.

The registration forms of the active clients must be updated by the institution each 24 months. All the relevant information (the registration form, the registries, and the documentation) must be maintained by the institution at the disposal of the CVM for a minimum term of five years as of the date the account is closed or of the latest transaction made in the name of the respective client. This term may be extended for an undetermined period of time in the event that there is an investigation conducted by the CVM and provided that this fact is formally notified to the person or institution. Transactions with securities which deserve special attention on the part of the institutions include those:

- Made between the same parties or having as beneficiaries the same parties, in which there is a repeated gain or loss with respect to any of the involved persons;
- Made with the purpose of producing a loss or gain and for which there is no an objective economic substance;
- Made with individuals resident or companies incorporated in countries and territories identified as non-cooperative in the circular-letters issued by the Council of Control of Financial Activities (COAF);

8 These recommendations have been made by the Financial Action Task Force on Money Laundering (FATF), which was established by the G-7 Summit in Paris in 1989 to develop a coordinated international response to set out the measures national governments should take to implement effective anti-money laundering programmes, and have been recognised, endorsed, or adopted by many international bodies.

- Settled in cash, if and when permitted;
- Made through private transfers of funds and securities, without any apparent motivation;
- Whose degree of complexity and risk seems incompatible with the technical qualification of the client or of his representative;
- Made with deposits or transfers made by third parties, for the settlement of transactions of the client, or for the rendering of guarantees in transactions carried out in future settlement markets; and
- Made through payment to third parties, under any form whatsoever, to settle transactions or redeem amounts deposited as collateral, registered in the name of the client.

In addition, an additional care is specially required in the case of certain clients, ie, non-resident investors, mainly when a trust or incorporated as a company with bearer shares, private banking clients, and persons politically exposed.

Any suspect transaction or proposal thereof must be reported by the institution to the CVM within 24 hours of the date it happens. When the client is included in the definition of 'persons politically exposed', this must be highlighted in the communication made to the CVM. The transactions are considered to be related to terrorism or its financing when performed by individuals who practice or plan to practice terrorist acts, or who participate therein or facilitate their practice, as well as by entities owned or controlled, directly or indirectly, by any such individuals and the individuals and entities who/which operate under their command.

Any financial institution or similar entity must develop and implement a manual of control procedures to comply with the requirements of the CVM Instruction and maintain a continuous training programme for its employees, aimed to divulgate the control and anti-money laundering procedures adopted by the institution. The institution must also have a director in charge of the performance of such obligations, who will have access to all the registration forms and data of all clients and to the information of any and all transactions made by clients.

Canada

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Canada

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Introduction

Regulatory System

The Canadian securities regulatory regime is designed to regulate the investment of capital in business enterprises and the resale of securities issued in consideration for that capital. Through these regulations, the Canadian regime provides safeguards which protect the investing public and promote confidence in the Canadian capital markets.

The regulatory framework is based on the securities regulatory model developed in the United States. Two principal activities are regulated. Firstly, the registration and control of market participants involved in the trading of securities are regulated through the imposition of a registration requirement whereby any person who purports to trade, advise, or underwrite the issue of securities must register unless an exemption from registration is otherwise available. Secondly, the disclosure of material information by issuers who propose to distribute securities to the public is regulated:

- Through the imposition of a prospectus requirement; and
- By imposing an obligation on publicly held companies to provide continuous disclosure about their activities.

Legal Sources

Canadian securities legislation is the domain of the 10 Canadian provinces and, accordingly, each province has enacted and administers its own securities legislation.

However, considerable uniformity exists between the provincial regimes, particularly in the regulation of primary and secondary market trading. Sources of securities law vary slightly from province to province, but they can generally be summarised as follows:

- Provincial Securities Acts — Each province has passed a statute dealing directly with securities regulation.[1] The Act sets out the broad framework for the regulation of securities trading generally in the province.
- Provincial Regulations — Each provincial Securities Act will have a corresponding set of regulations which set out much of the detail of how the Provincial Act will be administered.[2] These regulations are passed pursuant to powers granted under the Provincial Acts. Many of the requirements also are found in 'forms' included in the regulations. For example, regulations may include forms that prescribe the contents of prospectuses, proxy circulars, and take-over bid circulars.
- Regulatory Bodies — Typically, the provincial Securities Acts and regulations delegate adjudicative and administrative powers to a panel of commissioners (referred to as the provincial Securities Commission) or an administrator for that province.[3] The local provincial Securities Commission is the source of much of the securities law for that province. The provincial Securities Commissions are discussed in detail below under 'Authorities'.
- Policy Statements — Generally, the provincial Securities Commissions have the power to issue policy statements which set out the way in which their discretionary powers will be exercised. Typically, these statements will outline the broad policy to be applied

1 Securities Act (Ontario), RSO 1990, c S-5, as amended; Securities Act (Alberta), SA 1991, c S-6.1, as amended; Securities Act (British Columbia), RSBC 1996, c 418; Securities Act (Manitoba), RSM 1988, c S50, as amended; Security Frauds Prevention Act (New Brunswick), RSNB 1973, c S-6, as amended; Securities Act (Newfoundland), RSN 1990, c S-13, as amended; Securities Act (Nova Scotia), RSNS 1989, c 418, as amended; Securities Act (Prince Edward Island), RSPEI 1988, c S-3, as amended; Securities Act (loi sur les valeurs mobilières) (Quebec), RSQ 1990, c V-1.1, as amended; Securities Act, 1988 (Saskatchewan), SS 1988, c S-42.2, as amended. Canada's two territories also have enacted securities statutes: the Securities Act (Northwest Territories), RSNWT 1988, c S-5, as amended, and the Securities Act (Yukon Territory), RSY 1986. The territorial statutes are generally consistent with the statutes in the various provinces.

2 Securities Regulation (Ontario), RRO 1990, Regulation 1015, as amended; Alberta Securities Commission Rules, Alta Reg 46/87, as amended; Securities Rules (British Columbia), BC Reg 479/95, as amended; Securities Regulation (Manitoba), Man Reg 491/88R, as amended; General Regulation — Security Frauds Prevention Act (New Brunswick), NB Reg 84-128, as amended; Securities Regulations, 1991 (Newfoundland), Cons Newf, Reg 805/96; Securities Regulations (Nova Scotia), NS Reg 201/87, as amended; Securities Act Regulations (Prince Edward Island), RRPEI 1988, c S-3, as amended; Securities Regulation (Quebec), OC 660-83, as amended; Securities Regulations (Saskatchewan), OC 931/88, as amended.

3 The Provincial and Territorial Securities Commissions in Canada are as follows: Registrar of Securities, Government of the Yukon Territory Securities Registrar, Government of the Northwest Territories, British Columbia Securities Commission, Alberta Securities Commission, Saskatchewan Securities Commission, Manitoba Securities Commission, Ontario Securities Commission, Quebec Securities Commission (*Commission des valeurs mobilières du Québec*), Office of the Administrator, New Brunswick, Nova Scotia Securities Commission, Registrar of Securities, Prince Edward Island, and Securities Commission of Newfoundland.

as well as contain detailed requirements that must be met to meet the exercise of their discretion. Policy statements generally come in three categories: (a) national policy statements, which are joint policy statements agreed to by the provincial Securities Commissions in each province (collectively, the 'Canadian Securities Regulators'), designed to conform treatment across the country to specific issues of national concern; (b) multi-jurisdictional policy statements, which are joint policy statements of a number of the provincial Securities Commissions; and (c) local policy statements, which are statements of the local provincial Securities Commission.

- Blanket Orders and Notices — Blanket orders are normally granted by a provincial Securities Commission where a similar order has been frequently requested or a new policy has been developed for dealing with a particular situation. The blanket order will apply to anyone who fits the terms of the order and will relieve the provincial Securities Commission from dealing with numerous separate orders. Notices are circulated by a provincial Securities Commission to inform those concerned with a particular aspect of securities regulation of a development or proposed change. For example, a notice may advise of a proceeding, a draft policy, or blanket order being considered.
- Decisions and Rulings — Each provincial Securities Commission typically acts as an appeal tribunal from the decision of the administrator and has the power to issue decisions and rulings concerning the application of the provincial legislation. Most decisions of a provincial Securities Commission can be appealed to the Courts of its province. Therefore, decisions of the courts also can be a source of securities law in each province.
- Rules — In some provinces, the provincial Securities Commission has been given the authority to make rules having the effect of regulation in connection with specifically enumerated 'heads of power'.[4] This rule-making authority is intended to provide sufficient authority for the Securities Commission to make rules in respect of matters which are currently the subject of policy instruments or blanket orders or rulings, as well as those securities regulatory matters which may foreseeable arise in the near to medium term.
- Bulletins — Most of the provincial Securities Commissions publish important information about their activities in the form of bulletins which include, for example, notices, blanket orders, decisions, orders and rulings of the commission, new policies, new legislation, cease trade orders, new issues of securities, and insider-trading reports.

Authorities

The securities legislation in each province typically delegates adjudicative and administrative powers to a panel of commissioners known as the provincial Securities Commission. These provincial Securities Commissions are usually two-tiered structures with the first tier consisting of a panel of commissioners and the second tier consisting of an administrative

4 See, for example, Securities Act (Ontario), s 143.

agency headed by a chief administrative officer. The panel of commissioners has the power to make orders and rulings and also acts as an appeal tribunal from the decisions of the administrator. They also have the power to formulate policy and make recommendations to government for changes in legislation and regulation. The administrator, in comparison, exercises the administrative function assigned to the administrator under the provincial securities legislation and implements the decisions or directives of the commissioners. In a few provinces, Securities Commissions have not been created. Instead, the administrative responsibilities are assigned to government officials or administrators appointed under the provincial securities legislation.

There also are four principal stock exchanges in Canada which provide a major regulatory function. The four stock exchanges are:

- The Toronto Stock Exchange;
- The Montreal Exchange;
- The Vancouver Stock Exchange; and
- The Alberta Stock Exchange.

These exchanges are self-regulating, non-profit organisations created by statute to facilitate the trading of securities through members of the exchange. Each exchange passes its own by-laws and rules which govern the qualifications and continued fitness of members for membership in the exchange, set out requirements for the listing of securities and the conditions to be met by listed issuers to maintain their listing, and govern the manner in which trading in listed securities is to be conducted by members.[5] They also may issue policy statements providing guidelines as to how they will exercise the discretion given to them by their by-laws or rules.

The Investment Dealers' Association of Canada is another self-regulatory organisation of which all investment dealers in Canada are required to be members. The Investment Dealers' Association has rules regarding the conduct of its members and also dictates the qualifications required of its members.[6]

There are a number of other self-regulatory organisations such as clearing agencies and depositary institutions which are involved in the trading of securities and dictate the procedures and policies applicable to their function in the Canadian capital markets.

Procedures

The securities legislation in most provinces is based on the premise that investors are most effectively protected by requiring as many issuers of securities as possible to comply with

5 Toronto Stock Exchange General By-Laws, Rules, and Related Notices and Toronto Stock Exchange Company Manual (cited as 'TSE Company Manual'); Montreal Exchange (*Bourse de Montreal*) By-Laws, Rules, and Related Policies; Vancouver Stock Exchange By-Laws, Rules, and Related Policies; Alberta Stock Exchange General By-Laws and Member's Manual.

6 Investment Dealers Association By-Laws 1-37, Regulations 100-2300, and Related Policies and Forms.

the disclosure requirements of the legislation. The procedure adopted to accomplish this is described as the 'closed system'. The closed system ensures that securities that have not been qualified by prospectus disclosure will not be sold into the public markets and become freely tradable unless and until adequate public disclosure relating to those securities and their issuer is available and remains available through compliance with the continuous disclosure requirements. The closed system therefore requires that, before securities can be distributed to the public, a prospectus must have been filed and receipted by the provincial Securities Commission in each province in which the securities are to be offered.

The closed system recognises that full compliance in certain situations would be unduly burdensome and unnecessary. Therefore, it provides exemptions from the prospectus requirements based on criteria such as the nature of the securities, the transaction, or the participants in the transactions. However, where securities are issued in reliance on an exemption, they remain in the closed system and are prohibited from being freely traded in the secondary market until the prospectus disclosure requirements are met or a further exemption is available. In addition, there may be applicable hold periods, depending on the nature of the exemption relied on when the securities were acquired.

Legal Order and Regulatory Interests

Admission

Market Participants

In General. As a general proposition, absent being able to rely on a statutory exemption, only a properly registered entity can trade, underwrite, or advise in connection with securities transactions in Canada, whether in the primary or secondary markets. Canadian securities legislation generally provides broad definitions of the activities contemplated by the terms 'trade', 'underwrite', and 'advise', and an entity may be required to be registered as a result of one or more of these activities. The definition of 'trade' for these purposes is broadly defined, and it would include the disposition or sale for value of a security or an act in furtherance of such a disposition or sale.

Acts in furtherance of a disposition or sale would include things such as advertisement, solicitation, direct or indirect negotiation, or other conduct to facilitate a disposition or sale. The definition of 'underwriting' includes both purchasing as principle for resale, and also acting as agent in connection with a distribution, although subject to some exclusions. The definition of 'advise' applies to anyone engaging in, or holding themselves out as engaging in, the business of advising others on investments.

Registration Requirements. The definition of 'trade' specifically excludes the purchase of a security; thus, investors (other than certain institutional investors who wish to rely on exemptions available only to sophisticated purchasers) are generally not required to be registered. The registration requirement primarily catches those market participants involved in the selling and marketing of securities.

The intent of the registration requirement is to ensure that only reputable and qualified entities are involved in the selling and marketing of securities to the public. Registration encourages honesty, competence, and financial responsibility among registrants,[7] and it assists the Canadian Securities Regulators in pursuing enforcement actions where these objectives are not met.

Registrants may be required to be registered in one or more categories depending on their activities. The trading function (whether as principal or agent) gives rise to a requirement to be registered as a 'dealer'. In some provinces, the 'universal registration' system, described below, creates multiple categories of dealer registration.

The underwriting function gives rise to a separate registration requirement. Registered dealers are deemed to be registered as underwriters, although the underwriter registration is limited in a manner consistent with the registered entity's permitted trading activities (eg, an international dealer is deemed to be registered as an underwriter for securities offering primarily outside Canada). Other entities not registered as dealers may obtain registration as an underwriter, but this is not typical.

The advising function also gives rise to a separate registration requirement. Again, registered dealers are not required to register as advisers since they are specifically permitted to provide advice incidental to their dealer functions. Registration requirements apply both at the corporate level (requiring registration as a dealer, underwriter, or adviser) and at the individual level (applying to all trading or advising personnel under the sponsorship of the corporate registrant).

Registration is granted on application to the relevant provincial Securities Commission and is at the discretion of the Securities Commission (or the designated administrative arms), which also has discretion to impose any conditions on a particular registration and to suspend or cancel an existing registration. In most cases, registration must be renewed annually. Applications for registration are generally straightforward, and they must be in prescribed form. The main responsibilities applicable to registrants are in the areas of:

- Educational and proficiency requirements;
- Capital requirements;
- Contributions to the Canadian Investor Protection Fund (CIPF); and
- Financial reporting and the keeping of records.

Registrants also are required to notify the provincial Securities Commissions of changes in the information contained in an application for registration. Again, compliance with ongoing registration requirements is fairly straightforward.

Although the registration requirement arises from securities legislation, primary responsibility for supervision of registrants has largely been delegated to self-regulatory organisations (such as the Canadian stock exchanges, all of whose members are registrants,

7 United States readers should note the different terminology under Canadian securities legislation, where the term 'registrants' are generally dealers, underwriters, and advisers, rather than issuers.

as well as the Investment Dealers' Association). The Canadian Securities Regulators also retain broad enforcement powers regarding registrants and registration matters.

Registration Exemptions. Having set out the general requirement of registration to trade, underwrite, or advise, Canadian securities legislation provides a number of exemptions from the requirement to register as a dealer or adviser in certain circumstances. These exemptions, which generally relate to certain types of securities and types of trades, coupled with corresponding exemptions from the prospectus requirements discussed below, establish an 'exempt market' in Canada.

A discussion of all of the registration exemptions is beyond the scope of this chapter. Furthermore, many such exemptions are unlikely to be relevant in the international context. However, there are several registration exemptions that commonly arise in international securities transactions or may affect non-Canadian dealers, such as where securities are sold to sophisticated investors or in substantial amounts. These exemptions generally mirror available prospectus exemptions, and are discussed in more detail in the text below, relating to 'Trading Rules-Securities Offerings-Private Placements'.

Universal Registration. Some Canadian provinces, including Ontario, have created the overlay of 'universal registration' through the 'market intermediary' concept.[8] Under universal registration, any person who acts as a market intermediary (which is very broadly defined to capture activities relating to trading as principal or agent), is precluded from relying on most of the important registration exemptions unless registered under this scheme. In effect, universal registration brings persons who would otherwise be able to operate in the exempt market back under the registration requirement.

Under universal registration, dealers are registered in one or more of 10 categories of dealer registration, depending on the residency of the entity and the nature of the activities undertaken. Dealer registration categories include those of broker, investment dealer, and securities dealer.

There are two categories of registration that are particularly relevant to foreign dealers, ie, the international dealer registration and the international advisor registration. These registrations permit foreign dealers to carry on prescribed activities in Ontario without setting up a place of business.

International Dealer Registration. A foreign dealer with an international dealer registration in Ontario is entitled to trade in certain permitted securities with particular categories of investors under available prospectus exemptions.[9] Registration as an international dealer is simple and straightforward. The registrant is required to file with the Ontario Securities Commission (OSC) a prescribed form, a number of supporting documents, and a fee.

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8 See Part XI of the Securities Regulation (Ontario) and Part X of the Securities Regulations, 1991 (Newfoundland).

9 See Securities Regulation (Ontario), s 208.

Once registered as an international dealer, all salesmen, partners, and officials of the foreign dealer are exempt from the registration requirements when trading in securities in Ontario. It is through this registration that many United States and European dealers are permitted to extend international equity offerings into Canada on a private placement basis, as described in the text, below, relating to 'Trading Rules-Securities Offerings-Private Placements'.

International Advisor Registration. A foreign dealer who is seeking to provide advisory services to clients in Ontario or to clients distributing securities in Ontario will need to register as an international advisor before undertaking any advisory services.[10]

Registration as an international adviser will permit a foreign dealer to act as an adviser to clients in Ontario in respect of 'foreign securities', defined as securities issued by a non-Canadian corporation or government, and it permits them to provide advice in Ontario in respect of Canadian securities, but only to the extent that such activities are incidental to acting as an adviser in respect of foreign securities. The registrant is required to file with the Ontario Securities Commission a prescribed form, a number of supporting documents, and a fee.

Securities

In General. As in other legal systems, many securities in Canada are issued without complying with the requirement that dealers, underwriters, and advisers be registered, and without a prospectus. In Canadian terminology, these securities remain within the closed system and, provided appropriate exemptions continue to be available, such securities (typically, though not necessarily, of smaller private issuers) can be held and, in limited circumstances, transferred. There are a number of available prospectus exemptions which permit the distribution and sale of securities within the closed system. Those that are particularly relevant in the international context are discussed in more detail in the text, below, relating to 'Trading Rules, Securities Offerings, Private Placements'.

However, for securities to be issued to the public and become freely tradable afterwards, they must be initially placed, or otherwise move outside, the closed system, either as a result of being qualified under a prospectus, or by other means. Once outside the closed system, securities are generally freely tradable without a prospectus, but they generally must be traded through a registrant (or under an available exemption from the registration requirement).

Types of Trades Triggering Prospectus Requirement. Under Canadian securities legislation, as a general proposition, any 'trade' (as noted above, broadly defined) that constitutes a 'distribution' triggers the prospectus requirement. Essentially, three types of trades constitute a distribution, namely:

- Treasury issuance;
- Sale by a 'control person' (a statutory term generally meaning a 20-per-cent- or-greater security holder); or

10 See Ontario Securities Commission Policy 4.8, 'Non-Resident Advisers' (1988), 11 Ontario Securities Commission Bulletin 4569 (cited as 'OSCB').

- Trade by an issuer of previously issued securities that have been redeemed, repurchased, or donated back to the issuer.

Consequences of Filing Prospectus. As in other jurisdictions, a prospectus (which follows prescribed form under Canadian securities legislation) is a document which is intended to provide disclosure about the issuer and the security sufficient to permit prospective purchasers to make an informed investment decision. Preparation and clearance of prospectuses are the subject of more detailed treatment in the text, below, relating to 'Trading Rules-Securities Offerings-Full Canadian Offering'. However, it should be noted that two important consequences flow from filing a prospectus in Canada, namely:

- The issuer becomes a 'reporting issuer' subject to continuous disclosure and other requirements in each Canadian jurisdiction where the prospectus is filed; and
- Any misrepresentation in a prospectus can result in statutory civil liability for the issuer, its directors, any selling security holder, underwriters, and other parties.

Exemption from Resale Restrictions. Securities initially issued or placed without a prospectus, and therefore subject to resale restrictions, also can exit the closed system and become freely tradable. Under Canadian securities legislation, depending on the circumstances of the initial placement, resale restrictions may be overcome in one of two ways. In each case, the issuer of the security must be a reporting issuer (and, in some cases, must have been so for at least 12 months). If this condition is met, resale restrictions can be overcome if:

- The security has been held for a minimum period (ranging from six to 18 months, depending on the type of security); or
- Proper disclosure of the initial placement was made to the relevant provincial Securities Commission and if no unusual marketing efforts have taken place in connection with the resale.

Exit from the closed system by either method is not possible where the company does not become a reporting issuer (which will typically be the case in the international context). However, it may be possible for securities issued in Canada without a prospectus to be resold outside Canada, provided (among other things) that the principal market for the securities is outside of Canada and the securities are sold through the facilities of a foreign stock exchange.

Periodic Disclosure

Overview of Disclosure Requirements

In General. Once a company acquires reporting issuer status in any of the provinces in Canada, it is thereafter required to comply with the reporting obligations of that province, which typically require that they file the following disclosure documents on a continuous basis.

Annual Financial Statements. Annual financial statements must be filed with the provincial Securities Commissions together with an auditor's report within 140 days of the reporting issuer's year end. The reporting issuer also must deliver the financial statements to each holder of its securities in Canada concurrent with such filing.

Interim Financial Statements. Quarterly financial statements must be filed with the provincial Securities Commissions within 60 days of the end of each quarter. The reporting issuer also must deliver the quarterly financial statements to each holder of its securities in Canada concurrent with such filings.

Annual Information Form and Management Discussion and Analysis Requirements. In most provinces, a reporting issuer is required to file with the provincial Securities Commission an Annual Information Form (AIF) and a Management Discussion and Analysis (MD&A) of its financial condition and results of operations within 140 days of its financial year end. The Management Discussion and Analysis must either accompany the financial statements or accompany or be contained in the annual report of the reporting issuer and must be mailed to shareholders within 140 days of the financial year end.

Insider Reporting. Certain individuals and companies associated with reporting issuers must file insider trading reports in a prescribed form. The term 'insider' for these purposes generally includes:

- Directors and senior officers of a reporting issuer;
- Directors and senior officers of an issuer that is itself an insider or subsidiary of a reporting issuer;
- Any person or company that beneficially owns (directly or indirectly) voting securities of a reporting issuer or that exercises control or direction over voting securities of a reporting issuer, or a combination of both, carrying more than 10 per cent of the voting rights attached to all voting securities of the issuer for the time being outstanding; and
- Any reporting issuer that has purchased, redeemed, or otherwise acquired any of its securities for so long as it holds any of its securities.

Insiders are required to file an initial report disclosing any direct or indirect beneficial ownership of or control or direction over any of the securities of the reporting issuer. The rules also impose an obligation on all insiders to file further reports if there is a change in their ownership of securities.

Material Change Report. If a material change has occurred in the business or affairs of a reporting issuer, the issuer must forthwith issue and file a press release authorised by a senior officer of the reporting issuer, disclosing the nature and substance of the change and then file a corresponding material change report in prescribed form within 10 days following the date on which the material change occurs. A 'material change' is generally defined as:

> A change in the business, operations or capital of the issuer that would have reasonably been expected to have a significant effect on the market price or value of any of

> the securities of the issuer and includes a decision to implement such a change made by the board of directors of the issuer or by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable.[11]

In certain circumstances, a 'confidential' material change report, in lieu of the press release and report, may be filed where, in the opinion of the reporting issuer, disclosure of a press release and non-confidential material change report would be unduly detrimental to the interests of the reporting issuer.

Where a company has listed its securities on one of the stock exchanges in Canada, it also must comply with the timely disclosure requirements of the relevant exchange as well as with the disclosure requirements of the provincial securities legislation. The exchange requirements relating to the disclosure of material change are often broader than those under provincial securities legislation.[12]

Sanctions for Non-Compliance

There are several possible sanctions for failure to comply with continuous disclosure requirements or for misrepresentation contained in documents filed in compliance with the continuous disclosure requirements. These sanctions include:

- Penal sanction under most of the provincial securities legislation;
- Compliance orders issued by the provincial Securities Commission;
- Cease trade order by the provincial Securities Commission; or
- Removal of an issuer's right to use the various exemptions provided by the relevant provincial securities legislation.

There is currently no statutory civil liability for misrepresentation in secondary market disclosure documents, such as financial statements, proxy circulars, material change reports, and insider-trading reports. However, there can be statutory civil liability for misrepresentation in secondary market disclosure documents if the secondary market disclosure document is incorporated by reference in a prospectus (eg, in connection with the utilisation of the prompt offering prospectus procedure, as discussed in the text, below, relating to 'Trading Rules, Securities Offerings, Full Canadian Offering').

Generally, the civil liability remedy for misrepresentation in continuous disclosure documents will be a common law action for fraudulent or negligent misrepresentation. To make its case, a plaintiff will need to establish that it relied on the misrepresentation, which means it would need to successfully argue that it read the particular misrepresentation in the disclosure document, understood it, and invested on the basis of it. However, in the statutory civil liability regime applicable to disclosure in a prospectus, an investor need not prove reliance to succeed in a misrepresentation action against the issuer or other responsible party.

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11 See, for example, Securities Act (Ontario), s 1(1).
12 See, for example, part IV(B) of the Toronto Stock Exchange Company Manual.

Relief from Requirements for Foreign Issuers

In General. Where a foreign company has acquired reporting issuer status, it is *prima facie* required to comply with the continuous disclosure requirements set out above. However, discretionary exemptions from some of the financial reporting requirements may be available where a provincial Securities Commission is of the view that granting the exemption would not be prejudicial to the public interest. Described below are two categories of exemptions on which a foreign reporting issuer in Canada may seek to rely.

Deviation from Canadian Generally Accepted Accounting Principles. The Canadian Securities Regulator may accept financial statements not prepared in accordance with Canadian generally accepted accounting principles (GAAP) where it is not reasonably practicable for the issuer to revise the presentation in the financial statements to conform to generally accepted accounting principles. This exemption in effect permits foreign issuers to meet their continuous financial disclosure requirements without having to reconcile financial statements to Canadian generally accepted accounting principles.

Issuer Incorporated or Organised under Laws of Another Jurisdiction. Where a reporting issuer is subject to the laws of its incorporating jurisdiction concerning financial statement disclosure and there is a conflict between the laws of the incorporating jurisdiction and the laws of the applicable provincial securities legislation, most Securities Commissions will make an order exempting the reporting issuer from complying with the province's financial statement disclosure requirements provided the issuer complies with those of the incorporating jurisdiction.

Discretionary Exemption. Provincial Securities Commissions also are given the power to grant discretionary exemptions, subject to terms and conditions as they might impose, where they are otherwise satisfied in the circumstances of the particular case that there is adequate justification for doing so. This broad discretion may be used by a foreign reporting issuer where compliance with Canadian continuous disclosure requirements would create an undo hardship or little benefit is likely to be derived by investors in Canada. Factors that a commission might consider include:

- Number of security holders affected;
- Proportion of the securities held by security holders in the province to the total number of outstanding securities; and
- Substitute form of disclosure.

Multi-Jurisdictional Disclosure System and National Policy Statement 53 Issuer. There also is special treatment for foreign companies who have accessed the Canadian markets through either the National Policy Statement 53 (NP53) or the Multi-Jurisdictional Disclosure System (MJDS) offering regimes described below. Where the foreign company has become a reporting issuer pursuant to National Policy Statement 53, the ongoing continuous disclosure requirements are significantly modified by the discretionary

exemption orders which are required to be issued by the Canadian Securities Regulators in authorising the National Policy Statement 53 offering.

The exemption orders generally permit the foreign company to satisfy its Canadian obligations by filing in Canada the same materials that it files with the Securities Exchange Commission and the New York Stock Exchange and sending to Canadian holders the same materials it sends to its United States holders. Under the terms of the Multi-Jurisdictional Disclosure System, where a United States issuer offers securities in Canada through a prospectus or a take-over bid circular, it becomes a reporting issuer in each of the provinces where the securities have been offered and subject to the various provincial continuous disclosure obligations. In most instances, United States issuers also will be able to satisfy their Canadian disclosure obligation by filing the United States continuous disclosure documentation in Canada. United States issuers also can satisfy proxy and proxy solicitation requirements by complying with the United States requirements.

Proxy Disclosure

Where an information circular has been sent to shareholders of a reporting issuer in connection with a solicitation of proxies from the shareholders, a copy of the information circular also must be filed with the provincial Securities Commissions. The contents of the information circular must comply with the requirements of the relevant provincial securities legislation.

With respect to foreign companies, there are certain exemptions from the proxy and information circular requirements which are automatic in that they do not require an order from the provincial Securities Commissions.[13] For example, where the issuer is complying with proxy rules in the United States, it is exempt from the proxy solicitation and information requirements of the provincial securities legislation.

As with continuous disclosure obligations, a discretionary exemption also is available for a foreign company where the statute governing the incorporation or organisation of the company contains provisions regarding proxy solicitation and the content of proxy circulars which are inconsistent with the Canadian requirements. In such circumstances, the provincial Securities Commissions have the discretion to make an order exempting a foreign individual or company from complying with the proxy solicitation or information circular requirements of the relevant provincial securities legislation.

Trading Rules

Securities Offerings

In General. As stated above, as a general proposition, absent an exemption, to sell securities to the public, an issuer must prepare and clear a preliminary and final prospectus, and sales may only be made through registered dealers.

13 See, for example, Ontario Securities Commission Policy 7.1, 'Application of Requirements of the Securities Act to Certain Reporting Issuers' (1980), OSCB 46.

Securities qualified under a prospectus are issued outside the closed system and, subject to the issuer's continuing compliance with the continuous disclosure obligations described above, trade freely on stock exchanges or through registrants. In the international context, it may be useful to consider three types of securities offering structure, namely:

- Public offering, with full conformity with Canadian rules;
- Public offering, with partial conformity with Canadian rules under special regulatory schemes; and
- Private offering, with minimal conformity with Canadian rules.

Each of these types of offerings will require differing levels of compliance with Canadian securities legislation, both at the time of the offering (ie, prospectus disclosure and other offering rules), and on a going-forward basis (ie, continuous disclosure).

Full Canadian Offering. Like domestic issuers, foreign companies can undertake an offering to the public in Canada by complying in full with Canadian securities legislation. This option might be attractive to an issuer with significant operations in Canada or in an industry, such as precious metals or forest products, where Canada forms a significant part of the global market.

The Canadian public offering rules are broadly similar to those in the United States, although there are some important differences, as outlined below. The fundamental statutory principle is that no securities may be offered or sold to the public until a preliminary prospectus and a final prospectus have been prepared and filed in those Canadian jurisdictions where the offering is to be extended, and the Securities Commissions in those jurisdictions have issued a receipt for the preliminary and final prospectuses.

The 'receipt' concept merits some additional explanation. In Canada, the provincial Securities Commissions have the ability to refuse to issue a receipt, notwithstanding that a prospectus has been filed. This refusal would have the effect of prohibiting marketing and solicitations (in the case of the preliminary prospectus) or confirmation of sales (in the case of the final prospectus). While a formal receipt would only be withheld in unusual circumstances, offering participants need to be aware that 'receipting' of a Canadian prospectus is an important regulatory procedure, and not merely an acknowledgement that documents have been filed.

The Canadian preliminary prospectus corresponds to the United States 'red herring' prospectus, and it typically omits information relating to the size and pricing of the offering. Similar to United States practice, there is a waiting period after the filing and receipting of the preliminary prospectus to allow for the Canadian Securities Regulators to comment on the prospectus, which period usually corresponds with marketing efforts for the public offering. After those comments have been cleared (typically 20 to 30 days), a final prospectus is prepared and filed in Canada. Once the final prospectus has been receipted, the Canadian offering has reached a stage corresponding to 'going effective' in the United States, and the final prospectus is sent to prospective purchasers.

Prospective Canadian purchasers have a 'cooling-off' period of 48 hours after receiving the final prospectus, during which they can withdraw from their commitment to buy securities for any reason. After expiry of this period, the issuer and underwriters proceed to closing of the offering.

Canadian public offerings are generally done on an underwritten basis for senior issuers, although best-efforts agency offerings also are possible. As in other jurisdictions, underwriters (or selling agents) typically participate in determination of the offering structure and preparation of the prospectus and co-ordinate the marketing efforts for the offering.

A Canadian prospectus is required by statute to contain 'full, true and plain disclosure of all material facts', and civil liability (for damages or rescission) arises where a prospectus contains a misrepresentation, which is defined as an untrue statement of a material fact (or an omission to state a material fact). A number of parties involved in the offering can be liable for a misrepresentation resulting in a loss to an investor, including:

- The issuer and its directors;
- Any selling security holder;
- The underwriters; and
- Various advisers.

Other than the issuer or selling shareholder, these parties have a 'due diligence' defence available under the Canadian securities legislation and, therefore, extensive due diligence is undertaken in preparation of the Canadian prospectus.

A Canadian prospectus is required to comply with form requirements prescribed under the Canadian securities legislation, although the forms also contain a general provision that the prospectus disclose all material facts. The issuer and underwriters are required to provide a certificate that the prospectus contains full, true, and plain disclosure of all material facts relating to the securities offered as required by the securities laws of all the provinces of Canada and that it does not contain any misrepresentation likely to affect the value or the market price of the securities to be distributed.

The underwriters certification is qualified by their knowledge. Canadian prospectuses that are filed with the securities regulators also are required to be manually signed by the senior officers and directors of the issuer and by representatives of the underwriters, although the SEDAR electronic filing system (the Canadian equivalent of the United States EDGAR system) has recently alleviated many of the paper filing requirements for domestic issuers.[14]

Canadian prospectuses are required to contain financial statements of the issuer, generally comprising five years of historical information, audited and prepared in accordance with (or reconciled to) Canadian generally accepted accounting principles. A Canadian prospectus may require interim unaudited or *pro forma* financial statements, depending on the timing and circumstances of the issuer and the offering.

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14 National Instrument 13-101, 'System for Electronic Document Analysis and Retrieval (SEDAR)', (1996) 19 OSCB (Supp) 1.

Legislation in the Canadian province of Quebec (home to approximately one-quarter of Canada's population and a number of institutional investors) generally requires translation of prospectuses (including financial statements) into the French language. As French translation is typically done by the Quebec office of an issuer's auditors (for financial statements) and by special Quebec counsel to the issuer (for the balance of the disclosure), this can add substantially to the cost of undertaking a full public offering in Canada.

A foreign company completing an offering in Canada on the basis of a full public offering becomes a reporting issuer in all jurisdictions where it files a final prospectus, and generally becomes subject to the continuous disclosure obligations described in the text, above, relating to 'Periodic Disclosure'. The costs and ongoing obligations created by doing a full Canadian offering, as well as alternative procedures available for many foreign companies under the Multi-Jurisdictional Disclosure System and National Policy Statement 53 (see text relating to 'Public Offering under Special Regulatory Schemes') make a full Canadian offering an unlikely option for most foreign companies seeking access to the Canadian public capital markets.

While of limited relevance in the international context, two elements of the Canadian capital markets and regulatory regime should be noted for non-Canadian readers, namely:

- The Prompt Offering Qualification (POP) System;[15] and
- The 'bought deal' financing technique.

The Prompt Offering Qualification System is a regime available to issuers that meet certain reporting history (generally 12 months) and substantiality (generally Cdn $75 million in public float) criteria. The Prompt Offering Qualification System allows these issuers to offer securities to the public using a short-form prospectus (similar to a Form S-3 or F-3 filing in the United States), which incorporates by reference the issuer's continuous disclosure filings. The Prompt Offering Qualification System has increased flexibility and decreased transaction costs for many issuers in Canada, as the waiting period between the preliminary and final prospectus effectively decreases to approximately five days.

The Prompt Offering Qualification System also means that offerings for senior issuers can be completed in a matter of days after launch. These and other factors have given rise to the 'bought deal', an offering where an underwriter will approach an issuer and offer to purchase a specified number of securities immediately at a negotiated price, with the underwriter (usually supported by a syndicate) taking the market risk of successfully completing the distribution.

Public Offering under Special Regulatory Schemes. Prior to the 1990s, a full public offering in Canada was the only option to sell securities to Canadian retail investors. In the context of increasing internationalisation of securities markets, two Canadian regulatory developments have created alternate offering structures which give certain qualified

15 National Policy Statement 47 of the Canadian Securities Administrators, 'Prompt Offering Qualification System'.

foreign companies access to the public markets without having to comply in full with Canadian offering rules and continuous disclosure obligations.

Multi-Jurisdictional Disclosure System. In 1991, the Securities Exchange Commission and the provincial Securities Commissions in Ontario and Quebec, two of the principal Canadian jurisdictions, entered into a bilateral memorandum of understanding creating the Multi-Jurisdictional Disclosure System. The intent of this new regime was to reduce duplication in cross-border securities transactions in the United States and Canada. The Multi-Jurisdictional Disclosure System was subsequently adopted as a policy by all of the Canadian Securities Regulators.[16]

Under the Multi-Jurisdictional Disclosure System, Canadian or United States issuers that meet certain reporting history (generally 12 months) and substantiality (generally US $75 million in public float) criteria may make certain offerings of securities to the public in the other country on the basis of 'home country' prospectus disclosure requirements and under home country regulatory review procedures and timing. Issuers completing a Multi-Jurisdictional Disclosure System offering become subject to periodic disclosure requirements in the other country, but these can generally be satisfied by simply re-filing home country disclosure documents in the other country. The Multi-Jurisdictional Disclosure System has been a successful development in bilateral co-operation between Canada and the United States, although it has typically been used more often by Canadian issuers seeking access to the United States capital market than United States issuers seeking access to the Canadian capital markets.

National Policy Statement 53. In 1993, the Canadian Securities Regulators released a draft policy statement proposing a new Foreign Issuer Prospectus and Continuous Disclosure System.[17] National Policy Statement 53 permits substantial non-Canadian issuers (issuers who currently have, or expect to have on a post-offering basis, a market capitalisation of at least Cdn $3 billion) who are undertaking a fully registered United States offering to access the Canadian public capital markets on the same timetable as the United States offering, using essentially identical documents as those filed with the Securities Exchange Commission (with a few supplemental Canadian pages). The Canadian prospectus is generally not subject to substantive review by the Canadian authorities.

In particular, the Canadian supplement, or 'wrap', used in connection with a National Policy Statement 53 offering, consists largely of prescribed legends and disclosure items, as well as signed certificates essentially identical to those described in the text, above, relating to 'Full Canadian Offering'. The only non-prescribed disclosure in the Canadian wrap, other than a brief summary of the offering on the cover page, is optional disclosure of income tax considerations relevant to Canadian holders. The financial

16 National Policy Statement 45 of the Canadian Securities Administrators, 'Multijurisdictional Disclosure System'.

17 Draft National Policy Statement 53 of the Canadian Securities Administrators, 'Foreign Issuer Prospectus and Continuous Disclosure System' (1993), 16 OSCB 4125, as modified by Canadian Securities Administrators Notice (1995), 18 OSCB 1893.

statements in the prospectus used in Canada are not required to be reconciled to Canadian generally accepted accounting principles.

As described above, on completion of an offering under National Policy Statement 53, an issuer can satisfy its Canadian continuous disclosure obligations by filing its United States disclosure documents contemporaneously in Canada. Although a fairly recent development (and still, as of early 1998, a draft policy instrument, although several offerings have been completed on the basis of the draft), National Policy Statement 53 is an adaptation of the Multi-Jurisdictional Disclosure System model in that it permits access to the Canadian public capital markets on compliance with the United States rules.

Private Placement in Canada. The Canadian private placement market is well established, and it is generally possible for an international offering, particularly if it includes a United States registered offering or Rule 144A offering, to be extended to a number of significant Canadian institutional and sophisticated investors through the delivery to investors of the United States offering document with a brief Canadian wrap which generally consists of one or two pages.

The Canadian wrap summarises the terms of the Canadian private placement, but it consists mostly of representations acknowledged by the prospective purchaser as to its ability to invest without being provided with a prospectus. The types of purchasers who will be in a position to make these representations are financial institutions, purchasers who have applied to the Canadian securities regulators and received a designation as exempt purchasers and, in some cases, other purchasers who are prepared to purchase more than a prescribed amount of securities (typically Cdn $97,000 or Cdn $150,000, depending on the jurisdiction).

Under Canadian securities legislation, use of an offering memorandum for private placements which are not advertised is purely optional. However, market practice has developed such that an offering memorandum, usually in the form described above, is typically provided to investors. If an offering memorandum is used, generally the only substantive requirement under securities legislation in some provinces is that the issuer provide investors purchasing under certain specified exemptions with a right of action against the issuer for rescission or damages where the disclosure document contains a misrepresentation. This right, which corresponds to the rights Canadian investors would have in a public offering by prospectus, is generally called the 'contractual right'. In Ontario, a Rule provides that a contractual right need not be given to private placement investors in certain types of offerings, including an offering where the disclosure document is based on a United States or United Kingdom prospectus.[18] In other provinces, some sophisticated investors are permitted to purchase notwithstanding the absence of a contractual right.

18 Ontario Securities Commission Rule 71-5B, 'Certain International Offerings by Private Placement', (1997), 20 OSCB 1219, although this rule is scheduled to expire on 1 July 1998 and may be extended.

Private placements are usually extended to institutional investors in the provinces of Ontario, Quebec, British Columbia, and Alberta, where the majority of the potential institutional investors are located, but they can be made in more or fewer Canadian jurisdictions. Private placements have proved to be a cost-effective and timely way for a foreign issuer to have access to Canadian institutional investors. Significant expenses incurred in public offerings such as printing and translation are avoided. In addition, no regulatory review (and, in some circumstances, limited and readily obtainable consents) is required by the Canadian Securities Regulators.

However, by extending an offering to Canada on a private placement, sales are limited to certain specified institutional investors. In addition, there are restrictions on the dealers who may sell securities into Canada on this basis. In Ontario, for example, the offering may be made only by those non-Canadian dealers with an international dealer registration, or through appropriately registered Canadian-resident dealers, although no such restriction exists in most other provinces. Canadian securities legislation also imposes restrictions on the resale of securities sold by way of private placement. However, these resale restrictions may not apply to resales made outside of Canada. Finally, issuers completing a private placement in Canada do not become subject to Canadian continuous disclosure obligations.

Disclosure of Acquisition of Substantial Holdings

The Canadian rules regarding disclosure of the acquisition of substantial holdings (which are commonly referred to as the 'early warning' rules) are contained in the provisions of Canadian securities legislation governing public take-over bids. The relevant acquisition threshold for disclosure is 10 per cent (although other provisions of the take-over bid rules do not apply until the 20 per cent level is reached; see the text, above, relating to 'Trading Rules', and below, relating to 'Public Take-Over Bids'); purchases up to 10 per cent can be made anonymously.

Acquisition of beneficial ownership, control, or direction (by any means) of 10 per cent of any class of issued voting or equity securities of a Canadian reporting issuer triggers the early warning rules. It is not necessary that the 10 per cent be acquired in a block: acquisition of a single share that, when added to any other shares of that class already owned, crosses the 10 per cent threshold will activate the rules. Acquisition of securities convertible into voting or equity securities is considered to be acquisition of the underlying securities.

Securities owned or acquired by any person acting 'jointly or in concert' with an acquiror are relevant to the early warning rules (and the formal take-over bid rules). The 'joint actor' concept is intended to force disclosure of accumulations of securities by separate acquirors sharing a common intent. The determination of whether any person is a joint actor with a given acquiror is a question of fact. However, the Canadian securities statutes presume the following to be joint actors:

- Associates of the acquiror;
- Affiliates of the acquiror; and

- Anyone subject to any agreement or understanding with the acquiror regarding acquisition or voting of the acquired securities.

Calculation of the 10 per cent figure can become further complicated in the case of options, warrants, or conversion and subscription rights, as the underlying securities are required to be counted in certain circumstances. Once the early warning rules have been triggered, the acquiror is required to do the following:

- Immediately, it must issue a press release containing certain information described below;
- Within two business days, it must file a further report containing this information;
- Every time the acquiror (and joint actors, if any) acquires a further two per cent or more of the securities which triggered the early warning rules, the acquiror must again issue and file the documents referred to above; and
- Observe a one-day waiting period after dissemination of the documents referred to above before acquiring any further securities of the class.

Several of the concepts set out above merit further explanation. The information to be disclosed in the press release and report is intended to identify the acquiror and the details of the acquisition (ie, number of securities acquired and presently owned and purchase price) to the market and to inform the market of the acquiror's purpose of the acquisition and future intentions regarding the subject company. So long as the acquiror identifies joint actors, the latter are not required to file separate reports and press releases. Finally, the waiting period requirement also applies to joint actors with the acquiror, but does not apply once the acquiror (and joint actors, if any) has crossed the 20 per cent threshold, although the formal take-over bid rules (see the text, above, relating to 'Trading Rules', and below, relating to 'Public Take-Over Bids') will apply.

Although not specifically part of the early warning rules, acquisition of a 10 per cent holding in a class of voting securities (but not of equity securities without voting rights) of a public company in Canada also would confer 'insider' status on the acquiror (see text, above, relating to 'Periodic Disclosure').

There have been a number of proposals in recent years to revise the early warning rules, particularly given the five per cent trigger under equivalent United States rules. However, none of these proposals have been adopted.

Because of the objective nature of the triggering events and the apparent extraterritorial application of the obligations, the Canadian early warning rules, like the take-over bid rules, can lead to unintended take-over bids or early warning disclosure obligations. Acquirors of substantial holdings in public companies in Canada, whether or not the acquiror is Canadian, need to take care in this regard.

Insider Trading and Fraud

The securities legislation in each province generally prohibits individuals who are in a special relationship with a reporting issuer from trading in the securities of the issuer on

knowledge of material information that has not generally been disclosed to the public. This prohibition is based on the notion that trading should be based on equal access to information. Those having a 'special relationship' with the issuer include essentially everyone whose relationship with the issuer gives them access to information that the investing public does not have access to. This 'special relationship' would include the insiders described above in the discussion of insider reporting obligations but also would include:

- Officers and employees of the reporting issuer;
- Employees, affiliates, or associates of persons proposing to engage or engaging in certain business transactions with a reporting issuer, such as a reorganisation, amalgamation, arrangement, or take-over bid;
- Persons proposing to engage in business or professional activities on behalf of a reporting issuer where they are given access to information necessary to perform the business or professional function; and
- Anyone who, through their dealings with the issuer, has access to information about the issuer to which the investing public does not have access.

The prohibition on trading using undisclosed information extends beyond the duration of the relationship and the prohibition applies until the information has been made available to the investing public. The definition of 'special relationship' also extends to individuals who are not directly dealing with the issuer but obtain the information through someone who is in a special relationship (ie, a tippee).

The prohibition on insider trading extends to all individuals in a special relationship with a reporting issuer regardless of territorial boundaries. The sanctions for insider trading include penal sanctions, civil action, actions on behalf of the reporting issuer, or certain administrative sanctions, such as cease trade orders, removals of exemptions, or the prohibition from acting as a director or officer of a reporting issuer. All of these sanctions are difficult to impose on an individual residing outside of the jurisdiction. The administrative sanction are only effectively enforceable to securities market participants who are being regulated in Canada.

Public Take-Over Bids

Territorial Application (Foreign Bidder and Domestic Target). Take-over bids in Canada are regulated by provincial securities legislation and, for federally incorporated companies, the Canada Business Corporations Act (CBCA).[19]

Public take-over bids must be structured to comply with the securities legislation of each Canadian jurisdiction in which shareholders reside. A foreign bidder for a domestic target, therefore, must comply with the take-over bid requirements of each jurisdiction in Canada in which shareholders reside unless an appropriate exemption or other relief is available.

19 Canada Business Corporations Act, RSC 1985, c C-44, as amended.

Procedural Requirements. Under Canadian take-over bid rules, a take-over bid must generally be made to all holders of each class of voting and equity (participating) securities being purchased, and the same price per security must be paid to each holder of any class. The legislation also imposes minimum standards relating to disclosure, timing, and fairness.

A formal bid (referred to as a 'circular bid') is made pursuant to a take-over bid circular, which must contain prescribed information about the offer, the offeror and the target company. When the consideration for the bid consists (in whole or part) of securities of the offeror, the take-over bid circular must include prospectus-level disclosure about the offeror. It is generally not necessary to pre-clear the contents of a take-over bid circular with the provincial Securities Commissions. By filing a take-over bid circular where securities are offered as consideration, the offeror becomes a reporting issuer (if not one already) and is subject to the on-going disclosure requirements for Canadian public companies (see text, above, relating to 'Periodic Disclosure').

The determination of whether a take-over bid exists is based on the number of voting or equity securities owned and acquired. Under Canadian securities legislation, the take-over bid threshold is 20 per cent of any class of voting or equity securities. If the target company is incorporated under the Canada Business Corporations Act , the threshold is 10 per cent of any class of voting securities. There are special rules which must be taken into account when determining whether a threshold has been crossed, including rules relating to parties acting jointly or in concert.

Circular bids must be open for acceptance at least 21 calendar days. Where all the terms and conditions of the bid have been complied with or waived, the offeror must take up and pay for all deposited securities not later than 10 days after expiry of the bid. Shares deposited to a bid may be withdrawn for 21 days from the date of the offer and, if not taken up and paid for, after 45 days from the date of the offer. As well, deposited shares which have not been taken up may be withdrawn for 10 days from any variation in the offer unless the variation consists solely of the waiver of a condition to a cash bid, or solely of an increase in price and the bid (or extended bid) is open for a further 10 days.

Many Canadian public companies have adopted United States-style shareholder rights plans ('poison pills') which, in a take-over bid context, have the effect of enhancing the bargaining power of the target company's board of directors in dealing with the offeror. In particular, such plans provide the board with a means of requiring the offeror to extend the bid period beyond the statutory minimum, allowing the board additional time to explore alternatives to the bid.

Where a circular bid is made for cash, adequate arrangements are required to be put in place prior to launching the bid to ensure that required funds are available to effect payment, and these arrangements must be disclosed in the offering circular. Therefore, a bid cannot be conditional on obtaining financing. However, any other condition may be included in a circular bid. For example, it is common to provide that a bid is conditional on there being no material changes to the target. Furthermore, if a separate regulatory approval is required (see text, below), the bid will usually be conditional on obtaining such approval. Other than conditions imposed by the bidder itself (which can be waived),

there are no requirements that a specified minimum level of acceptance, such as 50 per cent, be obtained. Partial bids are permitted.

Any circular bid must be at the same price and for the same percentage as any purchases made by the offeror within the previous 90 days from any holder, unless those purchases were made on a basis available to all security holders of the class (for instance, on a securities exchange). As well, the purchaser under a circular bid is generally prohibited from any further purchases within 20 business days after the expiration of a circular bid unless such purchases are made on a basis available to all security holders of the class.

In addition, once a circular bid is announced, the offeror is generally prohibited from making any purchases outside the bid except where the intention to make such purchases is stated in the take-over bid circular, the purchases are made through the facilities of a major Canadian securities exchange in accordance with exchange rules, the purchases aggregate no more than five per cent of the class being acquired, and the offeror issues and files a daily press release disclosing the number of securities purchased. The rules also contain an 'early warning' reporting system described in the text, above, relating to 'Trading Rules' and 'Disclosure of Acquisition of Substantial Holdings'.

If, pursuant to a circular bid, an offeror acquires more than 90 per cent of the shares (other than those it previously held), Canadian corporate statutes generally provide a procedure for the compulsory acquisition of the balance of the shares. Where an offeror does not obtain the required percentage or is otherwise unable to use these rules, the offeror must comply with a detailed set of provisions relating to 'going private transactions' to acquire the balance of the shares (eg, by way of statutory amalgamation or arrangement).[20]

Such provisions can require the approval of a majority of the minority shareholders, as well as an independent valuation of the corporation. It is common for a circular bid to attempt to achieve the 90 per cent threshold but to indicate that the offeror will proceed to a second stage going private transaction to obtain 100 per cent if the 90 per cent is not achieved in the first instance.

Depending on the nature of the target and the size of the transaction, it also may be necessary to comply with other Canadian legislation. There are pre-merger notification requirements under competition rules which are broadly similar to the approach under the United States anti-trust legislation. In addition, for foreign bids over a certain threshold it may be necessary to obtain approval from Investment Canada under the general foreign investment rules. Furthermore, depending on the areas of business of the target (eg, broadcasting or utilities), it may be necessary to obtain approval under other specific legislation. The need to comply with these requirements is usually dealt with by specific conditions in the circular bid which generally extend the minimum time periods.

20 See, for example, Ontario Securities Commission Policy 9.1, 'Disclosure, Valuation, Review, and Approval Requirements and Recommendations for Insider Bids, Issuer Bids, Going Private Transactions, and Related-Party Transactions' (1977), OSCB 253.

Exemptions. There are various exemptions which, in certain circumstances, can be utilised in lieu of complying with the formal circular bid procedures.

Stock Exchange Bids. The major Canadian stock exchanges (Toronto, Montreal, Alberta, and Vancouver) have each developed a set of rules relating to cash take-over bids for listed shares through the facilities of the exchange.[21] Offerors that comply with these rules are exempt from the circular bid requirements. The stock exchange rules include requirements relating to equal treatment of shareholders, disclosure, and minimum time periods, which are substantially the same as for a circular bid. Securities exchange bids are now rare, however, since the applicable rules are more restrictive than for a circular bid in several respects, including in relation to consideration (cash only), withdrawal of the bid, permitted conditions, and availability of second stage transactions.

Normal Course Purchases. There is an exemption from provincial take-over bid rules which permits the holder of more than 20 per cent (10 per cent if the target is a Canada Business Corporations Act company) of a class of equity or voting shares (or a person acting jointly or in concert with such a person) to purchase up to an additional five per cent of the outstanding shares of that class in a 12-month period.

If there is a published market in the shares, the offeror may not pay more than the 'market price' of the securities (based on recent market activity), plus reasonable brokerage commissions actually paid. Provincial take-over bid legislation also provides a parallel exemption for normal course purchases of listed shares through the facilities of Canadian stock exchanges in accordance with stock exchange rules, which also impose a five per cent per 12-month limit.

Private Agreements. Private agreement purchases which result in the purchaser exceeding the take-over threshold are permitted in limited circumstances. The agreement must be with five sellers or less, and the sellers may not receive more than 115 per cent of the 'market price' of the securities. Collateral agreements cannot be used to indirectly provide increased consideration.

Other Relief. In addition to the foregoing specific exemptions, the provincial Securities Commissions will often grant discretionary exemptions from the take-over bid rules in appropriate cases. These can include circumstances where the holdings of securities in a jurisdiction are minimal, even if the terms or *de minimis* threshold of a relevant statutory exemption are not strictly met. In addition, the provincial Securities Commissions also have broad power to grant relief in other circumstances where they can be convinced it is in the public interest to do so.

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21 See, for example, Appendix F to the Toronto Stock Exchange Company Manual, 'Take-Over Bids and Issuer Bids through Toronto Stock Exchange Facilities'.

Recognition of Foreign Take-Over Regulation. The take-over bid rules in most Canadian provinces include an exemption from formal bid requirements if the number of holders resident in that jurisdiction are minimal and the offer is made in accordance with the rules of a specified foreign jurisdiction. In most provinces, in order for this exemption to apply, there must be fewer than 50 holders in the jurisdiction, holding less than two per cent of the outstanding securities of that class.[22] The foreign rules recognised for the purpose of this provision generally include United States securities laws, and (in Ontario, Quebec, and Alberta only) the United Kingdom City Code. As well, the provincial Securities Commissions will often grant discretionary exemptions from the take-over bid rules in cases where the holdings of securities in that jurisdiction are minimal, even if the terms of the relevant statutory exemption are not strictly met.

Jurisdictional Conflicts

Multilateral Solutions

Canadian jurisdictions have not been parties to any true multilateral solutions to jurisdictional conflicts in international securities regulation. While many of the Canadian securities regulators are active participants in multilateral organisations, such as IOSCO and COSRA, as well as the drive for international accounting standards, these efforts have had limited substantive effect to date.

There are a variety of explanations for this result at the international level. In the case of Canada, there are further complications to multilateral solutions due to the provincial nature of securities regulation and a relatively high degree of regulation for a market the size of Canada's.

Bilateral Solutions

At a bilateral level, there have been some successes between securities regulators in Canada and the United States. The most evident is the Multi-Jurisdictional Disclosure System (see text, above, relating to 'Trading Rules-Securities Offerings-Public Offerings'), which has been in effect since 1991 and which has proved to be a workable substantive law solution.

Given the relatively small size of the Canadian capital market, and the many similarities between the Canadian system and that of other countries, particularly the United States, unilateral approaches by some or all of the Canadian securities regulators have perhaps met with the most success. Two notable examples in the international context are National Policy Statement 53 which, in essence, represents deference by the Canadian Securities Regulators to the Securities Exchange Commission and to United States laws relating to public offerings and periodic disclosure, and the Ontario Securities Commission private placement rule, which currently provides partial relief from the otherwise applicable requirements where an issuer complies with applicable United States rules.

22 See, for example, Securities Act (Ontario), s 93(1)(e).

Procedural solutions in the absence of a multilateral or bilateral substantive law solution are generally not a part of the Canadian environment. To some extent, market participants may be able to structure transactions involving Canadian companies and investors off-shore, and they may be able to deal with Canadian institutional investors with limited application of Canadian securities laws.

However, the comprehensive and pervasive nature of Canadian securities regulation, together with the broad discretion of the Canadian securities regulators to intervene in capital markets matters, generally require that Canadian securities laws be complied with, or an available exemption be relied on, in transactions involving Canada or its residents.

Chile

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Introduction

Regulatory System

Chilean securities markets are principally regulated by the Securities and Insurance Superintendency (*Superintendencia de Valores y Seguros*) under the Securities Markets Law[1] and the Corporations Law.[2] These provide for disclosure requirements, restrictions on insider trading and price manipulation, and protection of minority investors.

The Securities Market Law sets forth requirements relating to public offerings, stock exchanges, and brokers, and it outlines disclosure requirements for companies that issue publicly offered securities. The Corporations Law sets forth the rules and requirements for establishing open stock corporations, while eliminating government supervision of closed (closely held) corporations. Open stock (public) corporations are those with 500 or more shareholders, or companies in which 100 or more shareholders own at least 10 per cent of the subscribed capital and all other companies that publicly offer their stock.

Legal Sources

Sources of law include:

- The Constitution;
- The Securities Market Law;
- The Corporations Law;
- Investment Funds Law;[3]
- Foreign Capital Funds Law;[4]
- Insurance Companies Law;[5]
- Banking Law;[6]
- Pension Funds Law;[7]

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1 Securities Markets Law, Law Number 18,045.
2 Corporations Law, Law Number 18.046.
3 Investment Funds Law, Law Number 18,815.
4 Foreign Capital Funds Law, Law Number 18,857.
5 Insurance Companies Law, Decree Having Force of Law, Law Number 251.
6 Banking Law, Decree Having Force of Law, Law Number 3.
7 Pension Funds Law, Decree-Law Number 3,500.

- Mutual Funds Law;[8]
- General Regulation Number 30 of the Stock Exchange and Insurance Superintendency;
- Chapter XXVI, title I, of the Central Bank Compendium of Foreign Exchange Regulations; and
- Circular Letter Number 1,375 of the Stock Exchange and Insurance Superintendency, relating to American Depositary Receipts.

Authorities

The Chilean regulatory authorities relating to securities include:

- The Securities and Insurance Superintendency;
- The Banking and Financial Institutions Superintendency (*Superintendencia de Bancos e Instituciones Financieras*); and
- The Pension Funds Superintendency (*Administradora de Fondos de Pensiones*).

Procedures

As provided in General Regulation Number 30, a register application must be submitted to the Stock Exchange and Insurance Superintendency. Its contents must include:

- General, economic, and financial background;
- Significant or substantial facts; and
- Other antecedents.

A letter signed by the general manager (or the person acting on his behalf), containing all the required information required in the present section and indicating the reasons for the application, must be enclosed. Once the issuer has provided all the information required and has complied with all formalities determined by the Securities and Insurance Superintendency, it will proceed to the registration in the Register of Stock. The Securities and Insurance Superintendency will issue a registration certificate once the process already mentioned has been completed. While the registration process is in progress, any change in the information provided must be submitted to the Securities and Insurance Superintendency.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. The Chilean stock market, which is regulated by the Securities and Insurance Superintendency under the Securities Market Law, is one of the most developed among the emerging markets, reflecting the particular economic history and

8 Mutual Funds Law, Decree-Law Number 1.019.

development of Chile. The Chilean government's policy of privatising state-owned companies, implemented during the 1980s, has led to an expansion of private ownership of shares, resulting in an increase in the importance of stock markets. This policy of privatisation extended to the social security system, which was converted into a privately managed pension fund system. These pension funds have been allowed — subject to certain limitations — to invest in stocks and are currently major investors in the stock market. Certain elements in the market, including pension funds administrators, are highly regulated with respect to investment and remuneration criteria, but the general market is less regulated than the United States market with respect to disclosure requirements and information usage.

The Santiago Stock Exchange was established in 1893 and is a private company whose equity consists of 48 shares held by 46 shareholders. As of 31 December 1995, 282 companies had accounts for 80.6 per cent of all amounts traded in Chile. Approximately 17 per cent of equity trading is conducted through the Chilean Electronic Stock Exchange, an electronic trading market which was created by banks and non-member brokerage houses. The remaining 2.4 per cent of equity is traded in the Valparaíso Stock Exchange.

Equities, closed-end funds, fixed-income securities, short-term, money-market securities, gold, and United States dollars are traded on the Santiago Stock Exchange. In 1991, the Santiago Stock Exchange initiated a futures market with two instruments, namely:

- United States dollar futures; and
- Selective Shares Price Index futures.

Securities are traded primarily through an open-voice auction system, a firm-offers system, or the daily auction. Trading through the open-voice system occurs on each business day in three sessions, from 10:30 a.m. to 11:20 a.m., from 12:30 p.m. to 1:20 p.m., and from 4:00 p.m. to 4:30 p.m. The Santiago Stock Exchange has an electronic system of trade (telepregón), which operates continuously for high volumes from 9:30 a.m. to 10:20 a.m.; 11:30 a.m. to 12:20 p.m.; and 1:30 p.m. to 3:50 p.m. Telepregón operates for low volumes from 9:30 a.m. to 4:30 p.m. The Chilean Electronic Stock Exchange operates continuously from 9:30 a.m. to 4:30 p.m. on each business day.

There are two share price indexes for the Santiago Stock Exchange, the General Share Price Index (IGPA) and the Selective Shares Price Index (IPSA). The General Share Price Index is calculated using the prices of more than 160 issues, and it is divided into five main sectors, namely:

- Banks and finance;
- Farming and forestry products;
- Mining;
- Industrials; and
- Miscellaneous.

The Selective Shares Price Index is a major company index, currently including the Stock Exchange's 40 most active stocks. Shares included in the Selective Shares Price Index are

weighted according to the value of the shares traded and account for more than 80 per cent of the entire market capitalisation. Securities exchanges are regulated by the Securities Market Law; additionally, regulations affecting open stock corporations also may be applied.

According to the Securities Market Law, securities exchanges are entities whose purpose is to provide their members the means required to carry out their transactions of securities efficiently, through continuous mechanisms of competitive auction, and to make possible for them to bring about other security trading activities that are proper according to law. The work performed by the securities exchanges is basic in the development of the financial market since, by authority of the Securities Market Law, they are bound to establish regulations for their activities and those of stock brokers and oversee the enforcement of those regulations in such a way as to ensure the existence of a fair, competitive, orderly, and transparent market.

Banks and financial institutions are not compelled to be registered in the stock brokers or securities brokers' registers to carry out trading activities, in accordance with the rights vested by the General Banking Law. However, they are subject to all other regulations set forth in the Securities Market Law. Stock brokers and securities dealers are responsible for the identity and legal capability of the persons hired through them, the authenticity and soundness of the securities they trade, the registration of the latest holder of such securities in the issuer's registers, whenever necessary, and the authenticity of the latest endorsement. The use of appellations such as 'stock broker' and 'securities dealer', or similar designations that involve the capacity of security trading, is restricted to persons and entities authorised to act as such according to the present law.

Transborder Electronic Trading Systems. Transborder electronic trading systems are not yet regulated in Chile.

Off-Market Transactions. Off-market transactions are not yet regulated in Chile.

Securities

National Treatment and Reciprocity. In general, no treaty exists between Chile and other countries for the reciprocal enforcement of foreign judgments. Chilean courts, however, have enforced, for example, judgments rendered in the United States by virtue of legal principles of reciprocity and comity, subject to the review in Chile of the foreign judgment to ascertain whether certain basic principles of due process and public policy have been respected without reviewing the merits of the case. However, there is doubt as to the enforceability, in original actions in Chilean courts, of liabilities predicated solely on foreign securities laws and as to the enforceability in Chilean courts of judgments of foreign courts obtained in actions predicated on the civil liability provision of the foreign securities laws.

The Corporations Law provides that all disputes arising among the shareholders in their capacity as such or among shareholders and a company or their administrators must be

submitted to arbitration in Chile. Notwithstanding the foregoing, a plaintiff has the right to submit the dispute to the ordinary courts of Chile. These provisions are mandatory, and they supersede the general rule described above. In addition, the Civil Code indicates that '[t]he Law is mandatory for all those who inhabit the Republic, including foreigners'.[9]

The Civil Code states that:

> . . . [g]oods located in Chile are liable to the Chilean laws, even if their owners are foreigners and do not reside in Chile. This provision must be understood notwithstanding the stipulations contained in legally sufficient contracts issued in a foreign country. However, for those contracts issued in a foreign country to be legally sufficient in Chile, they must be amended according to the Chilean laws.[10]

Issuer and Securities Requirements. The Securities Market Law regulates public offerings of securities and their respective markets and brokers, comprised of the stock market, stock brokers, securities dealers, issuers of instruments of public offerings, and secondary markets of such securities within and outside the stock markets. The Securities Market Law is applicable to all transactions in securities originating in public offerings and traded by brokers or dealers.

The Securities Market Law also regulates the stock market of companies and limited partnerships in which at least 10 per cent of their capital belongs to a minimum of 100 shareholders or that have 500 or more shareholders. Transactions of securities not mentioned in the foregoing paragraphs must be considered private in nature and will not be included among the provisions of the Securities Market Law, except in those cases in which it specifically cites them.

The Securities and Insurance Superintendency supervises the enforcement of the provisions of the Securities Market Law. Securities are understood as any transferable instruments, including stocks, stock options, bonds, debentures, mutual funds shares, savings plans, and negotiable instruments and, in general, any credit and investment instrument. Provisions included in the Securities Market Law do not apply to securities issued or guaranteed by the state, centralised or decentralised public institutions, or the Central Bank of Chile.

Public offerings of securities are those intended for the public in general, or for certain specific groups or areas within it. Should the need arise, the Stock Exchange and Insurance Superintendency is empowered to determine, by means of a general resolution, if certain types of securities offerings do constitute public offerings. The Superintendency may excuse certain public offerings from compliance with certain requirements by means of general resolutions.

Issuers that are undergoing the settlement of financial affairs will only be allowed to carry out public offerings of securities if they are holders of their own shares. According

9 Civil Code, art 14.
10 Civil Code, art 16.

to General Rule Number 30 of the Securities and Insurance Superintendency, issuing entities must provide information on:

- General, economic, and financial background of the applicant entity;
- General, economic, and financial background on affiliates and related entities; and
- Significant or substantial facts having, or that may have, a future impact on the development of the business of the entity, its financial statements, its securities, or their offer.[11] The registration application also must include the following documents and additional information.

Corporations. Corporations must provide:

- Authenticated copies of corporation deeds and their amendments;[12]
- Certificate from the corresponding Real Estate Registry, issued no more than 15 days after the date of application;
- Notice of any amendment or change regarding the corporation's bye-laws or the list of directors or liquidators and general manager, while the registration is still in process, together with the relevant documents; and
- Copy of the deeds modifying the bye-laws before their authentication, when the term for such a formality is still in effect.

Partnerships. In the case of partnerships, the following is required:

- Authenticated copies of the partnership deed and amendments;[13]
- Certificate from the respective Real Estate Registry, issued no more than 15 days after the date of application;
- Notice of any amendment or change regarding the corporation's bye-laws or the list of directors or liquidators and general manager or his representative, while the registration is still in process, to the Securities and Insurance Superintendency, together with the relevant documents;
- Affidavit in which all partners commit themselves not to dissolve the partnership, without prior authorisation from the Securities and Insurance Superintendency;[14] and
- Copies of deeds modifying the bye-laws before their authentication, when the term for such a formality is still in effect.

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11 Securities Market Law, art 9. 'Substantial information' is that which a judicious person would consider important with regard to his investment decision.

12 The current text must be submitted, including relevant information from the past 10 years. Should such updated text not be available, the last one in existence must be submitted, together with the amendments made from the date of its emission until the date of application.

13 The current text must be submitted, including relevant information from the past 10 years. Should such updated text not be available, the last one in existence must be submitted, together with the amendments made from the date of its emission until the date of application.

14 In cases involving limited partnerships, if the managing partner is another partnership, an affidavit of the nature above described is to be presented by it. The affidavit must be subscribed by all partners.

Additional Information. The following information is required from all applicants:

- A list of shareholders or partners arranged in alphabetical order at the date of application, indicating the number of shares or percentage of the rights held by each;
- A copy of the facsimile of the stock certificates that must be registered;
- The latest annual report presented to the shareholders or partners of the entity being registered;
- Notice of any changes in the information presented.

Registration Procedure. Once the shares to be issued have been registered by the Securities and Insurance Superintendency, the same information provided for the purposes of that registration must be delivered to all of Chile's stock markets within three business days after execution of the relevant certificate. The certificate must be delivered to the intermediate underwriters of such issuance before the date of initiation of the marketing process. The information must be permanently available to the public.

The register must make a distinction between those issues directed to the general public and those directed solely to the shareholders or those resulting from debt-equity conversions or mergers. In these last cases, a prospectus is not necessary, and a letter directed to the shareholders, in which the circumstances of the issuance are transmitted, will suffice. The application for registration must consist of a letter signed by the general manager or the person acting on his behalf.

A public offering of stocks that represents a debt with a term of over a year can only be carried out by means of bonds and subject to the general provisions established by law. Banks and financial institutions operating in the country are not subject to this limitation. When the registration of issued bonds is required, the issuer must present copies of the public instrument, together with the representative of the future bondholders, to the Superintendency. The representative must be appointed by the issuer in the same instrument, and he may be replaced at any time by the bondholders' general directorship.

Public offerings of stocks involving a debt and which expires in less than a year can only be carried out by means of a promissory note or other credit or investments instruments in compliance with the law and the requirements established by the Securities and Insurance Superintendency through the promulgation of general rules.

Prospectus Requirements. Prospectus and brochures providing information, employed for the promulgation and as advertising material of securities issuance, must contain all the information that the Securities and Insurance Superintendency determines, and they may be promulgated only after delivery to the Register of Securities. In general, the prospectus must provide information relating to:

- The intermediaries participating in the issue;
- The issuer;
- The legal background of the issue;
- The characteristics of the issue;

- The description of the placement; and
- The certificate of the issue registration.

Registration of Public Offerings. The Securities and Insurance Superintendency keeps a public register of securities. That register must include:

- Issuers of publicly offered securities;
- Securities that are subject to public offerings;
- Shares belonging to corporations and limited partnerships in which at least 10 per cent of their subscribed capital belongs to a minimum of 100 shareholders, or that have 500 or more shareholders; and
- Shares issued by corporations that voluntarily request to be registered.

Public offerings of securities can only be made when they and their issuers have been included in the Register of Securities. The registration of the securities and the corporation must be carried out within the 60 days following the date on which any of the aforementioned requirements have been fulfilled. Any corporation may choose to voluntarily register its shares. Voluntary registration subordinates the registered corporation to all the provisions and complementary regulations of this law.

The Securities and Insurance Superintendency must proceed to the registration in the Securities Register once the issuer has provided all the information required, regarding its legal status, economic situation, and financial standing.

The Securities and Insurance Superintendency may suspend the offering, negotiations, or transactions relating to any securities for up to 30 days if the public interest or that of the investors so require. The suspension may be extended to 120 days. The Superintendency also may annul the registration. No public offerings of securities can be carried out by issuers who cannot demonstrate their financial stability. The emission of publicly issued securities will be suspended if the issuer is found to be financially unstable.

Registration of Placements and Secondary Trade. The shareholders of a company, acting at an extraordinary shareholders' meeting, have the power to authorise an increase in such company's capital. When an investor subscribes for issued shares, the shares are issued and registered in such investor's name, even if not paid for, and the investor is treated as a shareholder for all purposes except with respect to receipt of dividends and the return of capital. The investor becomes eligible to receive dividends once he has paid for the shares (if he has paid only a portion of such shares, he is entitled to receive a corresponding *pro rata* portion of the dividends declared with respect to such shares, unless the company's bye-laws provide otherwise).

If an investor does not provide for shares for which he has subscribed on or prior to the date agreed on for payment, the company is entitled to auction the shares on the stock exchange where such shares are traded, and it has a cause of action against the investor for the difference, if any, between the subscription price and the auction proceeds. However, until such shares are sold at auction, the subscriber continues to exercise all the rights of a

shareholder (except the right to receive dividends and return of capital). Article 22 of the Corporations Law states that the purchaser of shares of a company implicitly accepts its bye-laws and any agreements adopted at shareholders' meetings.

The Corporations Law provides that, when a Chilean company issues new shares for cash, it must offer its existing shareholders the right to purchase a sufficient number of shares to maintain their existing ownership percentages in the company. Pre-emptive rights are exercisable or freely transferable by shareholders during a period which cannot be less than 30 days following the grant of such rights. During such period (for shares as to which pre-emptive rights have been waived), and for the ensuing period (up to the term fixed by the shareholders' meetings to pay the increase in capital, which cannot exceed three years), a Chilean open stock corporation is permitted to offer any unsubscribed shares for sale to third parties on terms which are equal to or less favourable to such purchasers than those offered to its shareholders. At the end of a 30-day period following the pre-emptive rights period, a Chilean open stock corporation is authorised to sell non-subscribed shares to third parties on more favourable terms to such purchasers, provided they are sold on a stock exchange.

Periodic Disclosure

In General

The registration in the Register of Securities compels the issuer to reveal in a reliable, sufficient, and timely manner all substantial information about itself, the offered securities, and the offer. 'Substantial information' is the information that a judicious person would consider important regarding his investment decisions.

Publicity, advertisement, and propagation made in any way by issuers, securities brokers, stock markets, securities brokers' corporations, or any other person or entities that play a role in issuing or in placing securities, may not contain statements, references, or representations that might lead to mistakes, ambiguities, or confusion about the nature, prices, feasibility, liquid assets, guarantees, or any other characteristic pertaining publicly offered securities or their issuers.

The Securities and Insurance Superintendency must keep a public register of presidents, directors, managers, administrators, and liquidators of the entities subject to its supervision. For that purpose, such entities, before the end of the third business day, must give notice regarding any appointment, vacancy, or replacement in the above positions. All appointments that are formally registered in the record will be understood as valid and in force for all the judicial and extrajudicial effects regarding stockholders and third parties in good faith.

Securities issued by banks or financial institutions operating in Chile need not necessarily be registered with the Securities and Insurance Superintendency, unless those securities consist of the institution's own shares, bonds, or other instruments as defined by the Banking and Financial Institutions Superintendency. The Securities and Insurance Superintendency also maintains a public register of risk-managing agencies.

Issuers of Registered Securities

The entities included in the Register of Securities must present to the Securities and Insurance Superintendency and to the public in general the same information that open stock corporations are compelled to provide.

American Depositary Receipts Disclosure

The regulations related to the emission of American Depositary Receipts are found in chapter XXVI, title I, of the Compendium of Norms on International Exchange of the Central Bank of Chile, under Conventions on the Purchasing of Company Stock and the Emission of Titles for their Transaction in Official Foreign Stock Markets or other Forms, and in Circular Letter Number 1375 of 12 February 1998 of the Securities and Insurance Superintendency. This norm regulates the issues that address the precise definitions of the entities that intervene in the operation.

Holders of American Depositary Receipts are subject to certain provisions of the rules and regulations under the Exchange Act relating to the disclosure of interests in shares of common stock. Any holder of American Depositary Receipts who is or becomes, directly or indirectly, interested in five per cent (or such other percentage as may be prescribed by law or regulation) or more of the outstanding shares of common stock must, within 10 days after becoming so interested and thereafter on certain changes in such interests, notify the company as required by such rules and regulations. In addition, holders of American Depositary Receipts are subject to the reporting requirements contained in articles 12 and 54 and title XV of the Securities Market Law, which provision may apply when a holder owns an amount of American Depositary Receipts that represents 10 per cent or more of the common stock or has the intention of taking control of a company.

The open companies that are registered in the Record of Stock that qualify according to the legislation of the United States and that carry out American Depositary Receipt operations must:

- Inform the Securities and Insurance Superintendency regarding the initiation of activities related to investment banks or legal consulting firms, with the purpose of studying the possibility to place their stock in foreign markets;
- Provide an estimate of the number of shares involved in the American Depositary Receipt program, the shares currently registered in the Record of Stock, the registered shares, and the registered and paid stock;
- Provide information as to the minimum price of the placement;
- Indicate if the American Depositary Receipts are a result of public or private offer;
- Remit to the Securities and Insurance Superintendency, on the first work day after its registration, a copy of the deposit contract;
- Remit to the Securities and Insurance Superintendency a copy of all the services contracts made before the Securities and Exchange Commission with the purpose

of registration of the emission of the American Depositary Receipts, as well as all the follow-up information after registration, in the same manner and on the same date when it was formalised;

- Compile, on a permanent basis, all information related to the emitter and given to third parties and remit it to the Securities and Exchange Commission within the following 48 hours;
- Report the registration of American Depositary Receipts with the Securities Exchange Commission, the stock markets, or any other system of transaction;
- Deliver to the Securities and Insurance Superintendency a genuine copy of the unused American Depositary Receipts, which must contain on one of its pages, in a highlighted fashion, a warning to all the holders of American Depositary Receipts of the main obligations that the stockholders have in Chile, especially those provided in articles 12 and 54, title XV, of the Securities Market Law;
- Include copies of the underwriting contracts and other documents that subscribe the American Depositary Receipt placement;
- Give notice of the initiation of the operations of the American Depositary Receipt placement in the foreign stock markets, providing price, amount, and conditions in the American Depositary Receipt placement;
- Inform the Securities and Insurance Superintendency of the name of the entity that functions as custodian and that remits the agreement that has been formalised between it and the deposit bank;
- Provide a monthly presentation to the Securities and Insurance Superintendency of the information of the transaction of American Depositary Receipts, including the price and number of units that were transacted; and
- Provide a quarterly presentation to the Securities and Insurance Superintendency of a list of all the stockholders of American Depositary Receipts that was provided to the deposit bank, within the first three days of the following month after this information was reported.

Article 36 of the General Banking Law states that no person may acquire, directly or indirectly, more than 10 per cent of the shares of a bank without the prior authorisation of the Superintendency of Banks. The prohibition also applies to beneficial owners of American Depositary Receipts. In the absence of such authorisation, any person or group of persons acting in concert will not be permitted to exercise voting rights with respect to the shares or American Depositary Receipts acquired. In determining whether to issue such an authorisation, the Superintendency of Banks considers a number of factors enumerated in the General Banking Law, including the financial stability of the purchasing party.

Article 84(2) of the General Banking Law imposes certain restrictions on the amounts and terms of loans made by banks to related parties. This presumption applies to beneficial owners of American Depositary Receipts representing more than one per cent of the shares.

Proxy Disclosure

The quorum for a shareholders' meeting is established by the presence, in person or by proxy, of shareholders representing at least an absolute majority of the issued voting shares of the company; if a quorum is not present at the first meeting, the meeting can be reconvened and, on the meeting having been reconvened, shareholders present at the reconvened meeting are deemed to constitute a quorum regardless of the percentage of the voting shares represented. The shareholders' meeting passes resolutions by the affirmative vote of an absolute majority of those shares or represented at the meeting. Additionally, a vote of two-thirds majority of the issued voting stock is required if a shareholders' meeting is called for the purpose of considering:

- A change of organisation, merger, or division of a company;
- An amendment to the term of duration or early dissolution;
- A change in corporate domicile;
- A decrease in corporate capital;
- The approval of capital contributions in kind and an assessment of such assets;
- A modification of the powers of shareholders or limitations on the powers of the board of directors;
- The transfer of all corporate assets and liabilities of the company or of all its corporate assets; or
- The form of distributing corporate benefits.

Chilean law does not require an open company to provide the level and type of information that United States securities law requires in connection with a solicitation of proxies. However, shareholders are entitled to examine the books of the company within the 15-day period before the ordinary annual shareholders' meeting. A notice of a shareholders' meeting, listing matters to be addressed at the meeting, must be mailed not fewer than 25 days prior to the date of such meeting and, in cases of an ordinary annual meeting, shareholders holding a prescribed number of shares must be sent an annual report of the company's activities, including audited financial statements. Shareholders who do not fall into this category, but who request it, also must be sent a copy of the company's annual report.

The Corporations Law provides that, when shareholders representing 10 per cent or more of the issued voting shares so request, a company's annual report must include such shareholders' comments and proposals in relation to the company's affairs. Similarly, the Corporations Law provides that when the board of directors of an open company convenes an ordinary meeting of the shareholders and solicits proxies for that meeting or distributes information supporting its decisions or other similar material, it is obligated to include as an annex to its annual report any pertinent comments and proposals that may have been made by shareholders owning 10 per cent or more of the company's voting shares who have requested that such comments and proposals be so included.

Only shareholders registered as such with a company at least five business days prior to the date of a meeting are entitled to attend and vote their shares. A shareholder may appoint another individual (who need not be a shareholder) as his proxy to attend and

vote on his behalf. Every shareholder entitled to attend and vote at a shareholders' meeting has one vote for every share subscribed.

Trading Rules

In General

Under article 12 of the Securities Market Law, certain information regarding transactions in shares of companies must be reported to the Securities and Insurance Superintendency and the stock exchanges. Shareholders are required to report the following to the Securities and Insurance Superintendency and the stock exchanges:

- Any direct or indirect acquisition or sale of shares that results in the holder's acquiring or disposing, directly or indirectly, of 10 per cent or more of an open stock corporation's share capital; and
- Any direct or indirect acquisition or sale of shares or options to buy or sell shares, in any amount, if made by holder of 10 per cent or more of an open stock corporation's capital or if made by a director, general manager, or manager of such corporation.

Insider Trading and Fraud

No person who, through his occupation, position, activity, or relationship, has access to privileged information may use such information for his own benefit or may purchase stocks of which he has privileged information, for himself or for third parties, directly or indirectly. In addition, it is forbidden to employ privileged information to obtain benefits or to avoid losses. It is equally forbidden to communicate such information to third parties or to recommend the purchasing or selling of affected stocks, directly or through subordinates or third parties.

Public Take-Over Bids

Under Article 54 of the Securities Market Law, persons or entities intending to acquire control, directly, of a corporation are required to inform the public of such acquisition at least five business days in advance through a notice published in a Chilean newspaper. The notice must disclose, among other information, the person or entity purchasing or selling, and the price and conditions of any negotiations. Prior to such publication, a written communication to such effect must be sent to the Securities and Insurance Superintendency and to the Chilean stock exchanges. Title XV of the Securities Market Law sets forth the basis to determine what constitutes a 'controlling power', a 'direct holding', and a 'related party'.

Jurisdictional Conflicts

The Civil Procedures Code provides that:

> . . . resolutions pronounced in any foreign country will have in Chile the authority granted by the corresponding treaties, and their performance will comply with the

> Chilean laws, unless these have been modified by the aforementioned treaties. Should there be no corresponding treaties on this matter with the country where the resolutions are originated, they will be given the same force that are granted to those verdicts that are
>
> pronounced in Chile. If the resolution proceeds from a country that does not comply with the verdicts of the Chilean legal courts, these will have no force in Chile.

Where none of the above cases can apply, resolutions of foreign courts will have in Chile the same force as that of Chilean judgments, as long as:

- They do not conflict with Chilean law;
- They do not conflict with Chilean jurisdiction;
- Proper notice has been provided to the defendant; and
- They have been formalised in compliance with the laws of the country where they were pronounced.

China

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China

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Introduction

In General

China started to develop its securities markets at the beginning of the 1980s.[1] The primary purpose of creating and developing a local stock market was to facilitate and deepen the modernizing reform of long-term financially troubled state-owned enterprises (SOEs). Along with the privatization of SOEs, SOEs have also been corporatized to become modern enterprises in terms of corporate governance, structure, and operation. As the capital markets were largely used by the Chinese government as a tool to rescue and finance the troubled SOEs, at least in its very initial stage, raising capital by listing on the Chinese stock markets was largely restricted to state-owned enterprises in the early 1990s, and privately held Chinese entities had little access.

More significantly, a stronger level of government involvement in the development of the capital markets is one of the key features of Chinese stock market. The regulatory mode of the securities market in China is a hybrid model of 'top down' and 'down top'. At the economic level, it was enterprises that make use of the capital markets to raise capital and attract investors, domestic or foreign. However, on the regulatory side, it is the central government that maintains a higher level of control over the listing process of prospective listing enterprises and the regulatory regime of the entire capital market. The opposite economic and regulatory forces led to severe competition between local governments to support their local entities to be listed first.

The Chinese securities market re-emerged in the mid-1980s when the Shanghai and Shenzhen municipal governments opened the stock exchanges in Shanghai and Shenzhen, respectively. These two stock exchanges became national securities markets in mainland China on 19 December 1990 and 3 July 1991,

1 The listing of state-owned enterprises on domestic stock exchanges emerged in the 1980s. The Joint Investment Company in Baoan County of Shenzhen issued the first public share certificates in 1983. Shanghai Feiyue Hi-Fi Corporation floated 10,000 shares at Renminbi 50 per share in November 1984. Tan Yanzhong Realty Co issued 100,000 shares two months later. These issues were handled by the Trust and Investment Company of the Shanghai Branch of the PBOC.

respectively.[2] Two stock exchanges apply the same listing rules and function as the single market. The securities market grows very fast in China. At the end of 1991, the first year of the formation of the Shenzhen Stock Exchange, there were twenty listed companies and the value of their shares was RMB 3.5 billion.[3] Both A shares and B-shares can be traded on the main boards of the Shanghai Stock Exchange and Shenzhen Stock Exchange. When the stock market was established, the first batch of listing companies were only 14 joint-stock companies with a total equity capital of RMB 600 million, and a total market value of approximately RMB 11 billion.[4]

The Securities Commission also was formed under the State Council in 1992 as the regulatory body of the stock market. The securities market experienced a high speed of expansion in the first several years of the 1990s. By the end of 1994, the number of listed companies on Shanghai and Shenzhen Stock Exchanges rose to 181 and 291, respectively, and the total market value of the stock market amounted to RMB 354.2 billion.[5] After two years' market downturn, the stock market moved towards another new phase of explosion in 1996–1998. By the end of 1998, the number of listed companies rose to 745 with the market value of RMB 2 trillion.[6]

The China Securities Regulatory Commission (CSRC) decided in January 2000 to establish a high-tech board so as to create separate indexes of the shares of high-tech companies. Along with the Silicon Valley success in the beginning of the 21st century, high-tech shares also boomed in China during the same period. Remarkable progress has been made in both the market size and value since 1991. By September 2002, the number of listed companies on both the Shanghai Stock Exchange and Shenzhen Stock Exchange surged to 1,212, and the market value of these securities was equal to 50 per cent of the GDP.[7] By 2004, the combined capitalization of the Shanghai and Shenzhen Stock Exchanges reached US $447.7 billion as the thirteenth largest stock market in the world.[8]

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2 A secondary market emerged along with many 'trading centers' scattered across the country in major cities by the late 1980s. These trading centers were under the supervision of local governments. R. Nottle, 'The Development of Securities Markets in China in the 1990s', (1993) 11 *Company and Securities Law Journal* 503.

3 Zhangzhe Li, *Finally Successful: The Report of the Development of Chinese Share Market* (in Chinese) (Beijing: World Knowledge Press 2000) 188.

4 Lusong Zhang, *Regulation of Foreign Mergers and Acquisitions Involving Companies Listed in China* (The Netherlands: Kluwer Law International 2007) 71.

5 Lusong Zhang, *Regulation of Foreign Mergers and Acquisitions Involving Companies Listed in China* (The Netherlands: Kluwer Law International 2007) 72.

6 Lusong Zhang, *Regulation of Foreign Mergers and Acquisitions Involving Companies Listed in China* (The Netherlands: Kluwer Law International 2007) 72.

7 See http://www.peopledaily.com, 27 October 2002.

8 World Federation of Exchanges, 'Domestic Market Capitalization' (6 May 2005), see http://www.fibv.com/publications/equity104.pdf.

In February 2008, the Shanghai Stock Exchange had 861 listed companies and 1,130 listed securities, and their market value reached RMB 233.4 trillion[9] while the Shenzhen Stock Exchange had 680 listed companies and 878 listed securities with the market value of RMB 55 trillion.[10]

Even in the global financial crisis and economic downturn, Chinese stock bourses in the amount of US $66.9 billion and the Hong Kong bourse with US $52.8 billion have raised almost triple the amount of money secured by initial public offerings (IPOs) across the United States in 2010, underscoring China's rise as a global financial powerhouse.[11]

Stocks are classified into four types based on the nature of their ownership: state shares, legal person shares, individual shares, and special shares. State shares are shares held by state-owned units (*danwei*) designated by the government. The sale and assignment of state shares are subject to government approval.

Legal person shares are shares held by a company or a legal entity with the status of a legal person. Individual shares are held by individual public investors or the staff of a company. These three types of shares are referred to as A-shares and, subject to recent developments, can only be purchased by Chinese nationals. By contrast, B-shares refer to special shares held by foreign investors (originally restricted to such investors, although PRC nationals are now also permitted to purchase B-shares).

Chinese capital markets are now open to companies funded through foreign investments. Both Chinese enterprises and foreign-invested enterprises (FIEs) are now allowed to list on either of the two stock exchanges. Listings by FIEs are subject to approval by the Ministry of Commerce and the CSRC. Although there was no specific prohibition against public offerings by FIEs, very few FIEs were actually able to conduct an IPO as the listing rules only covered local companies. In practice, FIEs have had very limited access to the A-share market in practice.

Regulatory System

At the initial stage, the regulatory authority was dispersed among a variety of ministries and commissions at the central government level. A dual regulatory regime evolved. The Securities Commission was responsible for macro control while the CSRC exercised specific regulatory functions. The principal regulatory authority regulating securities in China now is the CSRC with the support of the self-regulatory stock exchanges and securities industry association.

9 See http://www.sse.com.cn/sseportal/ps/zhs/home.html, 17 February 2008.

10 See http://www.szse.com, 17 February 2008.

11 Robert Cookson, 'Chinese Offerings Outpace Value of US IPO's, *Financial Times*, 13 December 2010, p. 18.

The CSRC became the sole regulator of the securities market in charge of approving and supervising the securities listing and trading in late 1997.[12] However, it was not regarded as an administrative agency until 1998 when the Securities Law 1998 came into effect and made the CSRC the sole regulator of the securities market. Thereafter, the CSRC rules were made administrative rules.

The day-to-day supervision and regulation of the securities market is delegated to the CSRC. The CSRC is empowered to supervise and administer participants in the securities industry, including securities issuers, listed companies, securities exchanges, securities companies, securities registration and settlement institutions, securities investment funds management institutions, securities investment consultancy institutions, credit rating institutions and professionals.

The CSRC is granted broad investigatory powers to enter the premises where illegal acts have been committed to investigate and obtain evidence; to question people, units and individuals involved in illegal acts; to check and duplicate records of securities transactions, financial accounts and other relevant documents and seal up and retain documents and materials; and to check funds accounts and securities accounts of people involved in illegal acts and apply to judicial institutions to freeze or to grant 'injunctions' where there is evidence that funds and securities, the subject matter of illegal acts, may be transferred or hidden.

Legal Sources

The Chinese securities market did not re-emerge until the mid-1980s after 40 years of non-existence. In great need of growing and regulating its securities market, China made great efforts to 'transplant' legal concepts and principles from other jurisdictions.

In this transplanting process, China learned a great deal from the United States and Hong Kong. Japanese and European experience has been less significant partly because these markets are less advanced than the United States market or much farther from Hong Kong, which is closer to China.[13] The legal transplant, however, may not be as effective as anticipated as some foreign legal concepts or principles simply do not suit the Chinese environment.

It is important to acknowledge the hierarchy of legal sources of securities regulations in China, from the upper to lower level: the constitution and laws passed by the National People's Congress and its Standing Committee; administrative regulations and local regulations; ministerial rules (including a

12 In the primary market, the Ministry of Finance, People's Bank of China and CSRC maintain the power to approve the issuing of state bonds, financial bonds and enterprise bonds, respectively.

13 Jane Fu, *Corporate Disclosure and Corporate Governance in China* (The Netherlands: Wolters Kluwer 2010) 129-130.

variety of commissions of the State Council); and local administrative rules. In addition, the listing rules of the Shanghai and Shenzhen Stock Exchanges also play a critical role in securities regulations.

China's securities sector has been undergoing continuous and dramatic changes as part of China's transition from a planned economy into a 'socialist market economy'. China is at an epochal juncture, where the regulatory infrastructure over Chinese banking, securities and insurance industries is still in the progress of evolution. It is anticipated that there will be a steady stream of new laws and regulations in these industries in the future.

Laws Governing the Securities Sector

Company Law

Comprehensive company law legislation did not exist in China until the adoption of the PRC Company Law in 1994, which applies to all types of company ownership including listed companies. The new PRC Company Law came into force on 1 January 2006, which substantially amended the Company Law 1994.

The significance of the Company Law in regulating the securities market reflects its established principles of fiduciary duty imposed on the directors. Under the Company Law, a director is not allowed to make use of his position to make personal gains. In addition, a director is under legal obligations not to conduct the same business as the company's business for their personal interests or for other people's personal interests.

The duty of loyalty also is imposed on directors, supervisors and senior executive officers as a general rule. The directors, supervisors and officers of the listed joint-stock company have the duty of information disclosure.

The new amendments to the Company Law only relax the regulatory regime by simply stipulating that the listing and trading of a company's stock on the stock exchanges shall be in accordance with the Securities Law, relevant regulations and listing rules of the stock exchanges.

Securities Law

The PRC Securities Law promulgated on 29 December 1998 and further amended on 27 October 2005 by the National People's Congress is the most comprehensive securities legislation issued in China. The Securities Law covers a wide array of matters ranging from domestic share issuances and trading to takeovers of companies limited by shares.

The new Securities Law is more market-orientated and substantially changed the administration of securities listing as well as lowered the criteria for stock to be listed on the stock exchanges. The new Securities Law replaced the old approval system (where the stock listing must be approved by the CSRC) with a new regime which provides that listing applications should be submitted to the stock

exchange for approval according to law. The new Securities Law also lowers the capital requirements for stock listing by a company from RMB 50 million to RMB 30 million,[14] and eliminates such restrictions as the three-year operating history, three-consecutive-year profit making history, and at least 1,000 shareholders holding shares of more than RMB 1,000 face value.[15]

The new Securities Law enhances the minority shareholder protection regime (by empowering shareholders to directly bring a lawsuit to the court in their own names if the board fails to take back stock illegally held by defined persons within a certain period of time upon request by the shareholders),[16] strengthens the disclosure rules (by requiring directors and officers to sign written confirmations on periodic reports),[17] and improves the legal liability regime concerning the misconduct of market actors and grants more administrative powers to the CSRC in enforcement.[18] These amendments indicate a more market-oriented approach taken by the government towards an infant but vibrant stock market.

The new Securities Law, however, lacks details in some respects. For instance, it only applies to A-shares and company bonds but not to B-shares, H-shares, N-shares, red-chips, and other securities listed outside China, government bonds, futures, and derivatives.

The Securities Law was not accompanied by a comprehensive review of previously adopted regulations, so that in many instances it remains unclear whether the new law supersedes earlier provisions. Concerns about the protection of minority shareholders' interests have not been adequately addressed in the Securities Law.

Securities Regulations

Apart from the Securities Law, a large number of regulations govern foreign investment in China's securities sector. For example, the Establishment of Securities Companies with Foreign Equity Participation Rules were promulgated on 1 June 2002 and amended on 28 December 2007, and the Administration of Securities Investment in China by Qualified Foreign Institutional Investors Procedures were promulgated on 24 August 2006 jointly by the CSRC and the PBOC.

The Administrative Measures for IPOs and Listings of Shares further improved the stock issue and listing rules by introducing detailed rules based on the relaxed criteria and market-oriented approach taken by the new Securities Law.

14 Securities Law 2005, art 16.
15 Securities Law 2005, arts 48–50.
16 Securities Law 2005, art 46.
17 Securities Law 2005, art 68.
18 Securities Law 2005, arts 10 and 11.

Fund Regulations

The key regulations in this sector are the State Council's Administration of Securities Investment Funds Tentative Procedures, effective as of 11 November 1997. The CSRC has elaborated on the Tentative Procedures by enacting some 20 regulations. In addition, the Shanghai and Shenzhen Stock Exchanges and the state Administration of Taxation also have adopted some rules regulating the funds industry.

China agreed to allow foreign investment into its funds sector on a restrictive basis. Since World Trade Organization (WTO) accession, joint venture fund management companies have been allowed with foreign investment up to 33 per cent, and pursuant to China's WTO commitments permitted foreign investment would eventually increase to 49 per cent within the following three years. Several of the world's leading financial firms have responded, establishing foreign-invested fund management companies with Chinese partners. Approval was granted by the CSRC in 2004 to ABN AMRO Asset Management to acquire a 33 per cent stake in Xiangcai Hefeng Fund Management.

Securities Investment Funds Law

The National People's Congress adopted the PRC Securities Investment Funds Law on 28 October 2003, which was effective as of 1 June 2004. The Securities Investment Funds Law is expected to be revised shortly. Possible amendments include:

- Formally allowing PRC funds to invest in offshore funds (this is what the QDII regime allows, but the Funds Law has not yet been revised to reflect this change in practice);
- Enlarging the scope of shareholders at fund companies;
- Boosting stock incentive programs for employees of FMCs;
- Allowing the establishment of corporate-type funds (to supplement the current portfolio of contractual-type funds);
- Expanding investment channels of mutual funds (to permit investment in private equity, real-estate investment trusts, and open-end funds); and
- Enhancing protection of public fund investors.

Governing Authorities

For a long time, the two stock exchanges were under the supervision of their local municipal governments, and the issuing and trading rules were set by the municipal governments with the approval of the People's Bank of China (PBOC).[19] The PBOC and other ministries issued a large number of rules on the issuing and trading of shares. The national regulatory body was established in October 1992, when the State Council established the CSRC and the Securities

19 Shenzhen Interim Measures for Share Issue and Trading 1991.

Commission, which was the national authority in charge of formulating securities policy on a unified basis and was subsequently made a part of the CSRC. Thereafter, the stock exchanges were under the administration of the local governments while being supervised by the CSRC.[20]

This dual-regulatory model was further confirmed in the Interim Measures of Administration of Stock Exchanges in July 1993. In 1998, the CSRC took over regulatory powers over the mainland securities market from the Securities Commission. Nevertheless, other ministries and commissions of the State Council may still exert varying level of influence over the company's business operation and management.

Each ministry or commission may set its own rules regulating one or more aspects of the securities market. For instance, supervision and control of market intermediaries such as securities companies, fund management companies, financial asset management companies, and trust investment companies has now been divided among the CSRC, the China Banking Regulatory Authority, and the China Insurance Regulatory Authority.

Although relevant ministries and commissions also may issue joint decrees,[21] there is not an effective coordination mechanism among these authorities. Local government also may be involved in the share issuance and trading if the listed company is transformed from an SOE. The very existence of multiple regulators does not necessarily improve the regulatory regime. Rather, it may increase the transactional costs and harm efficiency of the securities market as different authorities may have different policy concern, regulatory focus, legislative agenda, and monitoring tools.

China Securities Regulatory Commission

The Securities Law expressly confirms the CSRC's status of a centralized independent governing body. The functions of the CSRC include:

- Formulating laws and regulations in relation to the securities industry and exercise of the approval powers under the laws and regulations;
- Supervising and administering the issuance, trading, registration, custody, and settlement of securities;
- Supervising and administering participants in the industry including securities issuers, listed companies, securities exchanges, securities companies, securities registration and settlement institutions, securities investment funds management organizations, securities investment consultancy institutions,

20 Sate Council, Circular Number on Further Strengthening Macro-Administration of Securities Markets, December 1992.

21 The central government issued the Memorandum of Understanding on Division of Responsibilities and Cooperation in Financial Supervision and Regulation Among the CBRC, CSRC, and CIRC in late 2003.

securities depository and clearing institutions, securities service institutions,[22] credit rating institutions, and professionals;

- Formulating qualifications and codes of conduct for securities professionals;
- Supervising the proper disclosure of information on securities issuance and transactions;
- Supervising the conduct of the Securities Trade Association; and
- Investigating any conduct that violates laws and administrative regulations.

It is clear that the CSRC has the dual power of overseeing and managing the securities market and of standardizing existing law and regulations on a uniform and centralized basis. This centralization movement suggests that local and municipal governments have been removed from the law-making or IPO approval and selection process. The CSRC is granted broad investigatory powers to take the following actions:

- Entering premises where illegal acts have been committed to investigate and to obtain evidence;
- Questioning people and entities involved in illegal acts and requiring them to make statements;
- Checking and duplicating records of securities transactions, financial accounts, and other relevant documents and sealing up and retaining documents and materials that may be removed or concealed; and
- Checking funds accounts and securities accounts of people involved in illegal acts and applying to judicial institutions to freeze or to grant 'injunctions' where there is evidence that funds and securities, the subject matter of illegal acts, may be transferred or hidden.

The new Securities Law has apparently expanded the scope and nature of the securities under the CSRC's regulations, and granted more significant powers for the CSRC to exercise. The CSRC is now able to conduct on-the-spot investigations, including the power to freeze the accounts under investigation without an order from a judicial organ.[23] Nevertheless, in reality, the CSRC may have to coordinate with various authorities at different levels throughout China. In most cases, the CSRC must share regulatory authority over any potential listed company with both local authorities where the company is based and the ministry or commission in charge of the industrial sector in which the company operates. This indicates that the CSRC does lack the capacity to investigate and oversee all the aspects of the listed company's business operation, financial management, and regulatory compliance.

The new Securities Law also spells out a number of offences and penalties which the CSRC may impose (in conjunction with the exchanges and local

22 Securities Law 2006, arts 122, 155, 169, and 179.
23 Securities Law 2005, art 180(6).

authorities) on the relevant parties.[24] One commonly used sanction is to publish criticism, issued by the stock exchange on which the company is listed, against the company and/or any party found guilty of acts or omissions affecting the company's shares. Public criticism may be used together with the imposition of penalty such as a fine or other administrative penalty. The CSRC can also place the relevant company or person under judicial investigation. A company may be delisted and a professional's licence to operate in securities-related areas in the event of severe violations of law. Criminal actions have been more often used by the CSRC for combating securities market malfeasance, which may help strengthen the CSRC's enforcement.

Legal Order and Regulatory Interests

Market Participants

Securities Companies

Under the Securities Law 1998, only securities companies can act as brokers and are classified as comprehensive and brokerage securities companies.[25] Securities companies must apply for a business license. Comprehensive securities companies might engage in the following businesses: (a) brokerage; (b) securities business as a principal; (c) securities underwriting; and (d) other businesses approved by the CSRC.[26] Brokerage securities companies were not allowed to conduct other types of business except brokerage business.[27]

This restriction was removed in the Securities Law 2005. Accordingly, the scope of business of securities companies has been broadened to include not only acting as brokers and principals, but also financial and investment consultants, securities managers, as well as listing sponsors.[28]

Joint Venture Sino-Foreign Securities Company

China committed itself to, within three years after accession to the WTO, permitting foreign securities institutions to establish Sino-foreign joint venture securities companies in China, with up to one-third of the total equity interest being held by foreign investors. Nevertheless, China made no commitment as to when, or if, it would permit foreign companies and banks to increase their equity interest in joint venture securities companies above one-third, or to establish wholly foreign-owned securities companies in China.

Prior to China's accession to the WTO, *ad hoc* approvals had already been issued. Thus, China International Capital Corporation Limited, a joint venture

24 Securities Law 2005, Part Eleven.
25 Securities Law 1998, art 119.
26 Securities Law 1998, art 129.
27 Securities Law, art 130.
28 Securities Law, art 125.

set up by Morgan Stanley International Incorporated and China Construction Bank, had already been in operation for approximately six years. Another joint venture securities company, BOCI Securities Co Ltd, was set up in March 2002 with 49 per cent owned by Bank of China International Holdings Co Ltd. At present, Sino-foreign securities companies are allowed to:

- Underwrite A-share offerings;
- Underwrite and trade B-shares, H-shares (ie, Hong Kong-listed but non-Hong Kong registered), and government and corporate bonds; and
- Launch managed funds.

Joint venture securities companies can engage in business directly without any Chinese intermediaries but may not engage in trading of equity shares for their own accounts. Foreign investors can now participate in the Chinese securities sector in a variety of ways, including through:

- The Qualified Foreign Institutional Investor (QFII) Program (which allows a QFII to bring capital into China and purchase A-shares and listed bonds directly, subject to various limitations);
- The establishment of foreign-invested fund management or securities companies; and
- The purchases of B-shares, H or N (ie, New York-listed) shares, or shares of red chips (ie, Hong Kong-registered and listed companies whose principal business assets and operations are inside China).

In addition, a foreign entity may be engaged by a QDII security institution to act as an investment advisor if it satisfies such qualifications as having participated in the investment management business for more than five years and having securities assets in the most recent fiscal year valued at no less than US $10 billion.

An emerging funds industry has been developing in China for several years. As at December 2006, China now has 58 fund management companies that have developed more than 300 securities investment funds under the umbrella of eight fund custodians. It is estimated that the total assets of the existing Chinese funds are worth in excess of RMB 856 billion, which accounts for merely 11 per cent of the capitalization of the A-share market. Investment funds is a growing part of the China's securities markets. Foreign securities firms are encouraged to joint venture with Chinese securities companies or acquire a stake in Chinese securities companies. The qualification requirements for foreign investor include:

- Being a securities firm licensed to conduct securities business in its country of incorporation and a record of operating in the financial sector for more than 10 years;
- Having not been subject to any material sanction imposed by any securities regulatory body or judicial department during the previous three years;

- Having a sound internal control system;
- Having a good reputation and good business achievements in the international securities market and its various risk control targets for the previous three years and having met the legal requirements in the country of incorporation; and
- For a joint venture securities company, having registered capital of no less than RMB 500 million with the equity interest held by the foreign party not exceeding one-third of the total registered capital of the joint venture.

In the life insurance sector, foreign insurance firms are entitled to establish Sino-foreign joint ventures with up to 50 per cent foreign ownership. In the non-life insurance sector, foreign firms are permitted to establish branches and subsidiaries in China. The threshold for being registered as a Sino-foreign joint venture is 25 per cent foreign equity. A foreign insurer which applies to set up insurance business in China must have been in the insurance business for more than 30 years at the time of application and total assets at year-end prior to submission of the application must be greater than US $5 billion (or US $500 million for insurance brokerage business applicants). The applicant must have had a representative office in the PRC for more than two years.

Stock Exchanges

There are only two securities exchanges in China, one in Shanghai and the other in Shenzhen. Both are non-profit entities. Only securities companies which are registered as members of a securities exchange may participate in the trading of securities by centralized bidding. Two stock exchanges have primary control over the daily trading of domestic shares, and also scrutinize listing applications.[29]

A stock exchange may impose more specific or stringent listing conditions in addition to the listing conditions in the Securities Law as long as the prior approval is obtained from the CSRC. Securities exchanges are empowered to suspend, resume, or terminate the listing or trading of company shares[30] and bonds in accordance with law.

This seems a decentralizing move, a departure from the CSRC to a more autonomous stock exchange-based regulatory regime. The CSRC delegated authority to the stock exchanges as to the decisions on suspending the listings of companies that turn into consecutive losses.[31] Securities exchanges are required to make allocations to a risk fund from membership fees and transaction levies.

29 Securities Law 2005, arts 48 and 52–54.
30 Securities Law 2005, arts 55–56.
31 CSRC's Suspending and Terminating the Listings of Loss-making Listed Companies Implementing Procedures 2001.

Admission

When joining the World Trade Organization (WTO), China promised that licensing criteria in the financial services sector would be solely prudential and there would be no economic needs test or quantitative limits on licences. The base requirements imposed on the foreign investors in the banking industry include being of ongoing profitability; having a good credit rating; having no record of major violation of laws and regulations; having experience in international financial activities; and having effective policies on anti-money laundering activities.

In order to qualify to invest, the foreign investor's total assets at the end of the preceding year must, in principle, have been at least US $10 billion if the target is a commercial bank or a municipal or rural credit union and at least US $1 billion if the target is a non-bank financial institution such as a finance company. According to China's WTO Agreement, China is committed to open its securities industry based on the following timetable:

- By 2001: representative offices in China become Special Members of PRC Stock Exchanges; joint venture (33 per cent) to conduct domestic securities investment fund management business; foreign securities institutions may directly trade B-shares; and
- By 2004: joint venture (49 per cent) in fund management business; joint venture (33 per cent) in underwriting A-shares and underwriting and trading of B- and H-shares as well as government and corporate debts, and launching of funds.

Although foreign companies may trade Chinese shares, they cannot issue shares in the Chinese securities market. Foreign investors can invest in Chinese stock exchanges via various routes. The most common way is to subscribe for B-shares, which are available to foreign investors, including investors from Hong Kong, Macau, and Taiwan. Another route is to invest through the QFII scheme.

Authorization and Registration Process

The approval for the establishment of a Sino-foreign joint venture securities company involves a two-phase process. The first phase entails the filing of an application with the CSRC by a representative jointly appointed by the shareholders, the review of the application by the CSRC, a decision by the CSRC on whether or not to approve the application, and registration with the state Administration of Industry and Commerce (SAIC) if approval is granted by the CSRC.

The second phase involves the filing of an application with the CSRC for the Securities Business Operation Permit. A foreign investor may choose to acquire a stake in an existing Chinese securities company and to apply for the conversion of the domestic securities company into a foreign investment securities company, which requires approval of the CSRC.

Securities

Types of Securities

A-Share vs. B-Share. A-shares are domestically listed shares of Chinese companies while B-shares, often known as 'domestically listed foreign investment shares' or 'special RMB-denominated shares', are ordinary shares of Chinese listed companies that are listed on the domestic stock exchanges but traded in either Hong Kong dollars or United States dollars. A publicly listed company in China may artificially have two or more classes of shares, A-share, B-share, and H-share (or N-share, S-share).[32] Both A and B-shares are domestic shares (as they are traded in domestic stock exchanges) while H, N and S-shares are foreign capital shares (denominated in foreign currency) and are listed on the Stock Exchange of Hong Kong, New York Stock Exchange, and Singapore Stock Exchange, respectively. Upon the approval of the CSRC, an A-share company listed either on the Shanghai or Shenzhen Stock Exchange may simultaneously issue B-shares to foreign investors on the same stock exchange.[33]

B-shares, however, carry the same voting rights and claims on the company's earnings and assets,[34] even though B-shares are quoted in RMB but are settled in a foreign currency, typically United States dollars on the Shanghai Stock Exchange and Hong Kong dollars on the Shenzhen Stock Exchange. Similarly, B-share dividends are paid in United States dollars for Shanghai-listed stocks and in Hong Kong dollars for Shenzhen-listed stocks. H, N, and S-shares are listed on the Hong Kong, New York, or Singapore Stock Exchanges and the trading of them is denominated in Hong Kong dollars, United States dollars and Singapore dollars, respectively.

The issuing and trading of B-shares was as early as 1988 when the Shenzhen Development Bank issued and traded B-shares in Hong Kong dollars, before the release of B-share trading rules issued by the Shenzhen Interim Measures Concerning Administration of RMB Special Shares on 5 December 1989, and the nation-wide rules, that is, the Provisions on Listing of Foreign Investment Shares Inside China by a Shareholding Company issued by the State Council on

32 The share capital of a listed company in China also is segmented depending on who owns or can lawfully own the shares. For instance, legal person shares are listed and eligible for trading on domestic or overseas stock exchanges while non-legal person shares such as state-owned shares cannot be traded on stock exchanges and can only be transferred pursuant to private transactions and government approval is required.

33 According to the Measures for the Administration of Securities Investments in China by Qualified Foreign Institutional Investors ('QFII'), issued by the CSRC, People's Bank of China and State Administration of Foreign Exchange on 24 August 2006, under the QFII scheme, foreign investors can also participate in China's debt and equity markets by acquiring A-shares in China's domestic stock exchange.

34 In most countries where restrictions are imposed on foreign investment, foreigners pay a premium above the price paid by local investors. Nonetheless, this is not the case in China where B-shares held by foreign investors trade shares at a substantial discount relative to A-shares held by local investors.

25 December 1995 as well as the Provisions on Listing of Foreign Investment Shares Inside China by a Shareholding Company Implementing Rules of 3 May 1996. The B-share market has not been formally open to domestic residents with certain limitations until February 2001.[35]

These limitations include that a domestic resident may open B-share trading accounts and trade B-shares if he deposits his foreign exchange at a bank located within China, and the trading of B-shares must be through a broker. Nevertheless, given the existence of a black market for foreign exchange, domestic residents participated in the B-share market much earlier and their illegal participation also triggered the passing of the Circular Number on Strict Control of Opening of B-share Trading Accounts by the CSRC in June 1996 with the purpose of cracking down on the trading of B-shares by domestic residents. However, given the number of eligible investors for B-shares, the size of B-shares was once only five per cent of the tradable capitalization of the A-share market[36] and remains small and, more importantly, the market remains illiquid. By November 2006, among 1,396 listed companies, merely 109 companies issued B-shares, while 1,345 companies issued A-shares.[37]

As A-shares and B-shares are different in that they have different issuing purposes, objectives, and trading currencies, there are separate and common rules regulating their IPOs. The purpose of differentiating B-shares from A-shares was mainly to encourage investment from outside mainland China while RMB is not freely convertible.[38] Although B-shares are freely traded, they were prohibited from being converted into A-shares.

The underlying rational of this restriction is to isolate A-shares from inflows of foreign capital so that the domestic market can be protected from international market volatility. The differentiation of A and B-shares resulted in a separate set of forces of demand and supply, thereby producing different prices and earnings ratios. As a result, the same share may be priced differently in A and B-shares market. For example, between 1992 and 1993, the index for A-shares received positive returns while the index of B-shares received negative returns, which in turn affected the pricing and trading volume of each share.[39] In effect, B-shares were traded at a discount to A-shares even though they are both issued by the same listed company.

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35 CSRC, the Decision on Domestic Residents' Investment in B-share Market (19 February 2001).

36 Alice de Jonge, *Corporate Governance and China's H-Share Market* (Cheltenham: Edward Elgar 2008) 55.

37 See http://www.csrc.gov.cn, 24 November 2006, where 86 companies issued both A and B shares.

38 Gao Xiqing, 'The Perceived Unreasonable Man – A Response to Fang Liufang', (1995) 5 *Duke Journal of Comparative and International Law* 271, 312.

39 T.K. Ramsey, 'China: Socialism Embraces Capitalism? An Oxymoron for the Turn of the Century: A Study of the Restructuring of the Securities Markets and Banking Industry in the People's Republic of China in an Effort to Increase Investment Capital' (1998) 20 *Houston Journal of International Law*, 451, 477.

The defects of segregating the stock market are well recognized by practitioners, scholars, and government officials. China has started to unveil legislation with the goal of dismantling the dichotomy between shares reserved for citizens and those reserved for foreigners. The latest movement is the implementation of the Administration of Securities Investments in China by Qualified Foreign Institutional Investors Tentative Procedures and the Notice on Relevant Issues Concerning the Transfer to Foreign Investors of Listed Company state-owned Shares and Legal Person Shares. Accordingly, foreign investors are now able to participate in both the A-share market as well as B-share and H-share markets. Meanwhile, domestic investors also are able to open trading accounts for B-shares.[40]

Purchase of A-Shares. The CSRC and the People's Bank of China jointly issued the Interim Measures Concerning Administration of Investment Inside China by Qualified Foreign Institutional Investors (the 'QFII Tentative Measures'), which became effective as of 1 December 2002. Under the QFII scheme, foreign investors that satisfy prescribed qualifications are able to invest in A-shares,[41] state bonds, corporate bonds, and other financial instruments subject to the approval by the competent authorities.[42] A foreign investor must open a RMB bank account with a Chinese bank and Chinese securities companies for trading purposes. However, a single QFII cannot hold more than 10 per cent of the aggregate A-shares in a single listed company. The aggregate limit of all QFIIs' investment in a single listed company may not exceed 20 per cent of the company's total A-shares.[43]

The CSRC, PBOC, and SAFE jointly issued the Administration of Securities Investments in China by Qualified Foreign Institutional Investors Procedures ('New QFII Rules') in August 2006, which came into effect on 1 September 2006. The new QFII Rules lower the threshold of being a QFII, in particular, to insurance companies and fund management companies.[44] Accordingly, pensions, charitable funds, donation funds, trust companies, government investing management companies can now apply for the QFII qualification.[45] The lock-up period for QFII investment is shortened to three months for pensions, insurance capitals, and mutual funds. In addition, QFII is allowed to open securities accounts under their own names instead of jointly opening accounts with domestic securities companies and custodian banks.[46] Every QFII

40 'B Shares Open to Domestic Investors,' *China Daily*, 20 February 2001.

41 Ministry of Foreign Trade and Economic Cooperation and CSRC jointly promulgated the Opinions on Several Issues Concerning Foreign Investment in Listed Companies in November 2001, which permit foreign-invested enterprises to purchase non-publicly tradable shares from Chinese listed companies.

42 QFII Interim Measures, art 18.

43 QFII Interim Measures, art 20.

44 QFII Measures, art 10.

45 QFII Measures, art 2.

46 QFII Measures, arts 16 and 24.

can appoint three domestic securities companies for securities trade on two stock exchanges in China.[47]

Purchase of B Shares. A Chinese company limited by shares, subject to the CSRC approval, may issue shares to designated or non-designated investors overseas, and the shares may be listed overseas (including being transferable on overseas stock exchanges.[48] If a company plans to do so, it should lodge a written application, together with relevant supporting documents, to the CSRC for approval.[49]

The State Council regulated the issue and trade of B-shares by issuing the Foreign Capital Shares Provisions in December 1995. Foreign capital shares entitle shareholders to the same rights. Similarly, the holders of foreign capital shares also bear the same obligations that the holders of RMB shares do.[50] The Foreign Capital Shares Provisions also define the scope of investors capable of investing in foreign capital shares, and outline the requirements that a company must satisfy in order to apply for approval to issue foreign capital shares.

The State Council Securities Commission in 1996 released the Listing of Foreign Capital Shares Inside China by a Company Limited by Shares Provisions Implementing Rules, which provide for the issue, listing, trade, registration, and clearing of B-shares, disclosure information, and accounting and auditing issues related to B-share issue and trade. A company limited by shares may issue foreign capital shares to specified or unspecified investors inside China and list shares on the stock exchanges.[51] Subject to the approval of the CSRC, foreign capital shares listed inside China may be circulated and transferred outside China.[52]

Types of Shares in a Shareholding Company Converted from SOEs. Shares in China can be classified into four categories: state shares, legal person shares, employee shares, and public individual shares in a shareholding company transformed from an SOE. In companies that are established by share issue, there are state shares, legal entity shares, and public individual shares.

Both state shares and legal person shares are state-owned shares. The percentage of state-owned shares in an SOE is subject to the government's decision, ranging from 40 per cent to 80 per cent. The key feature of the state-owned shares was its non-transferability, which resulted in a low liquidity of the

47 The Notice Concerning Certain Issues in the Implementation of the QFII Procedures, art 15.

48 Special Regulations of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares, art 2.

49 Special Regulations of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares, art 5.

50 Foreign Capital Shares Provisions, art 5.

51 The Listing of Foreign Capital Shares Inside China by a Company Limited by Shares Provisions Implementing Rules, art 3.

52 The Listing of Foreign Capital Shares Inside China by a Company Limited by Shares Provisions Implementing Rules, art 24.

securities market. This situation has recently improved due to the passage of the State Council's Regulations on Division of state-owned Shareholding. The non-transferability of state-owned shares leads to the unique phenomenon of 'a dominant single shareholder', which suggests that the state has the dominant holding of shares with voting rights.

It was reported that listed companies with state control once made up 80 per cent of the stock market in China.[53] By June 2002, 6five per cent of the listed companies had the state as their largest shareholder.[54] The existence of state-owned shares involves the government in the operation of SOEs or holding companies after their transformation, and may harm the rights of minority shareholders, in most cases, individual shareholders.

The existence of a large portion of state-owned shares reduced the liquidity of the securities market. The CCP decided to reduce part of the state-owned shares in the Fourth Meeting of the Fifteen Congress in September 1999. The reduction place had two steps: to reduce the state-owned shareholding to 51 per cent; and to further reduce the state shareholding by need.[55] Two companies were chosen by the CSRC to conduct an experiment of the share reduction plan through share allotment in October 1999. In these experiments, state-owned shares were sold to the holders of transferrable shares in the same company at a price higher than the company value but 10 times less than the issue price.[56] In June 2001, the Ministry of Finance, with the approval of the State Council, released the Measures on Reduction of state Shareholding.

Due to the market plunge, the CSRC had to stop the experiment by issuing the administrative directives with the State Council's approval on 23 October 2001. While the CSRC was seeking public feedback on the share reduction plan, it formally stopped the experiment in June 2002. The state-owned shareholding reduction was not resumed until 2005 when the CSRC started to implement the shareholding division plan.[57]

Legal person shares are the shares purchased by the companies and legal entities, as opposed to natural persons. By June 2002, 31 per cent of the Chinese listed companies had a legal person as their largest single shareholder.[58] Legal person shares can be further divided into five sub-groups. Shares owned by a

53 A White Book on the Chinese Listed Companies in 2002, *Shanghai Securities Daily*, 26 May 2003.

54 *Report on the Problems of the Chinese Securities Market,* (Beijing: Social Science Publishing House 2003) 79.

55 Li Zhangzhe, Finally Successful: The Report of the Development of Chinese Share Markets, 606.

56 Li Zhangzhe, Finally Successful: The Report of the Development of Chinese Share Markets, 606.

57 CSRC, Circular Number on Experiment in Shareholding Division in Listed Companies.

58 *Report on the Problems of the Chinese Securities Market* (Beijing: Social Science Publishing House 2003) 79.

legal person that are owned by the state are named state-owned legal person shares. Together with state shares, they are together called state-owned shares. If the issuing entity is a shareholding company transformed from an SOE, many legal person shares are acquired by the senior officers of the company. If the issuing entity is not an SOE, most legal entity shares are acquired by other enterprises. Shares owned by collective enterprises (which can be established by a local government, derived from the state, or invested by individuals but attached to an administrative department for tax benefits) are collective enterprise legal person shares.

Private enterprises also may own shares. In this case, these shares are called private enterprise legal person shares. Similarly, shares owned by foreign-invested enterprises such as equity joint ventures, cooperative joint ventures, and wholly foreign-owned enterprises are named foreign-invested enterprise legal person shares. Investment funds and pensions (with legal person status) also may own shares.

Thus, these shares are institutional legal person shares. Similar to state shares, legal person shares are not freely transferrable. Both legal person shares and state shares were prohibited from being traded freely in the stock market. Moreover, both state shares and legal person shares were not available to foreign investors due to the regulatory restrictions such as the Notice on the Suspension of Transfer State Shares and Legal Person Shares of Listed Companies to Foreign Investors in 1995.[59] Legal person shares could only be traded through a separate electronic network.[60]

As the majority of a Chinese listed company's issued and outstanding shares are non-publicly tradable state shares and legal person shares, the purchase and acquisition of these shares are important in the acquisition of corporate control. As discussed above, given their uniqueness, the rules applicable to the purchase and acquisition of state shares and legal person shares are separate from those to freely tradable shares. A number of regulations and rules regulate the purchase and acquisition of state or legal person shares by the foreign investors. For instance, the Ministry of Finance issued the Notice on the Issues Relating to the Administration of State-owned Shares in Companies Limited by Shares on 1 July 2000, according to which approval from the Ministry of Finance is needed for the acquisition. The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies was issued jointly by the CSRC, the Ministry of Finance, and the State Economic and Trade Commission in November 2002.

59 This was not changed until 2002 with the Notice on the Relevant Issues Concerning the Transfer to Foreign Investors of Listed Companies State Shares and Legal Person Shares.

60 Kan, 'Domestic Investors to Get Shares of Huge Stock Issue', *China Daily*, 5 February 1994.

Thus, a qualified foreign investor[61] is technically able to become a controlling shareholder in a listed company. The transfer of state shares and legal person shares in listed companies to foreign investors should not only comply with the Foreign Investment Industrial Guidance Catalogue [62] but also the CSRC regulations and listing rules.[63] State or legal person shares should be transferred through public bid.[64] Foreign investors who acquired state or legal person shares are subject to a 12-month lock up period after full payment of the entire transfer price is made.[65] However, the listed company whose state or legal shares have been transferred to foreign investors are not qualified to be a foreign-invested enterprise. In other words, such a listed company should be operated as usual.[66]

Individual Chinese citizens may own shares. These shares are termed individual shares, and can be further divided into two sub-groups: internal employee shares and public individual shares. Public individual shares are offered to the general public. By contrast, internal employee shares are the shares that the company issues internally to its employees as staff benefits. These shares are usually sold at a minimal price, which is much lower than that for publicly issued shares. Directors and senior managers may receive more employee shares than other employees. However, in the early stage, employee shares were not freely transferrable even though holders of employee shares were entitled to dividends and new share allotments. In 1992, employee shares were allowed to be traded on the capital market as shares issued to and traded by the general public.

When these shares are sold in the market, the employees will receive a premium due to the difference between the issue prices of different types of shares, which further forms a black market. In response to the problems in connection with the employee shares, the Urgent Circular Number Concerning Immediate Prohibition on Non-standard Issue of Employee Internal Shares was distributed by the State Council on 3 April 1993. According to this Circular Number, the issuance of new shares would not be approved; employee shares could not be transferred within three years after their issue; these shares could only be transferred between company employees three years after the issue; these shares

61 The qualification of a foreign investor includes its strong operational and managerial capabilities, financial status, reputations, ability to improve corporate governance, etc. The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies, art 3.

62 The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies, art 2.

63 The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies, art 4.

64 The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies, art 3.

65 The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies, art 7.

66 The Notice on Relevant Issues Concerning the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares in the Listed Companies, art 9.

could only be traded in the market three years after their listing; and the black market of share trading must be cracked down on.

The State Commission of Restructuring the Economic System (SCERS) subsequently issued a series of regulations strengthening the regulatory regime: the Regulations Concerning Employee Shareholding in Companies Issuing Shares to Designated People of 5 July 1993 (which imposed limitations on the issuing and trading of employee shares); and the Circular Number Concerning Correction of Irregular Practices of Employee Shareholding by Joint-Stock Companies Issuing Shares to Designated Companies of 5 July 1993 (requiring companies which issued employee shares after 3 April 1993 to cancel such share issues and refund the capital and interest to employees). From 1994 onwards, the employees were no longer able to subscribe to shares before IPOs. Instead, the employees may be granted with the stock options. The issuance of employee shares was formally put to an end in 1998 when the CSRC issued the Circular Number Concerning the Stoppage of Issuing Company Employee Shares. This was a substantial step to moving towards a free and uniform securities market.[67]

The segregated share structure and impossibility of cross-trading between different share markets *de facto* protected the infant securities market in China and, more importantly, kept private investors, foreign or domestic, from acquiring corporate control of listed companies. State control remains a strong Chinese characteristic in the stock market. In 2002, for instance, fewer than 200 listed companies out of the total 1,200 companies did not have state ownership.[68]

The immediate consequence is the low liquidity, small market scale and excessive speculation in the marketplace. The dominance of state control in the Chinese stock market indicates that the market itself is not designed as a tool to deprive the state of control in SOEs or to promote Western capitalism. By contrast, it appears that the market is devised to enhance a socialist economic or market order. The share classification and segment also added more difficulty in regulation and operation of stock markets as various shares are governed by separate trading and issuing rules.

H-Shares. H-shares are issued by PRC-incorporated companies listed on the Stock Exchange of Hong Kong and are subscribed for and traded in the foreign currency by Hong Kong and foreign investors (without restrictions). The abbreviation of H represents Hong Kong. Due to the listing activities in Hong Kong, the issuing companies must comply with Hong Kong Companies Ordinance and listing rules of the Hong Kong Stock Exchange even though they are incorporated in the PRC and have to comply with PRC Company Law and other laws and regulations. The face value of H-shares is denominated in

67 However, the listing rules of the Shanghai and Shenzhen Stock Exchanges still contain provisions concerning the employee shares.

68 J.R. Woetzel, *Capitalist China: Strategies for a Revolutionized Economy* (Singapore: John Wiley & Sons (Asia) 2003), 11.

Renminbi but subscribed for and traded in Hong Kong dollars. The issuer of H-shares must operate according to two separate and different legal systems: on the one hand, the mainland Chinese legal system, which is widely viewed as a relatively underdeveloped regime and, on the other, the Hong Kong legal system, a common law originated and well-developed regime.

In this sense, H-share firms inevitably reflect combined dimensions and tensions of both Chinese and Hong Kong systems.[69] The availability of H-shares suggests that the Chinese market and legal system may not necessarily economically satisfy the needs of foreign investors as well as domestic companies. Foreign investors want to invest into Chinese portfolio companies but the investment of B-shares may encounter some practical difficulties due to the non-convertibility of Renminbi. For performing domestic companies, the vulnerable and weak Chinese securities market may not satisfy these companies' financial needs. Therefore, the Hong Kong securities market is a natural option.

The listing of H-shares must be approved by the State Council. The first Chinese company listed in Hong Kong was Tsingtao Brewery Company, which was one of nine companies approved by the State Council to be listed in Hong Kong.[70] The selection of the first batch of nine firms by the Chinese government represented a range of different industry sectors and regions.[71] Most early H-shares were issued by the foreign-listed arms of large state-owned enterprises. More recent years saw more and more private companies and small or medium-sized enterprises listed in Hong Kong and other offshore stock exchanges.

The main requirements that should be satisfied for the purpose of the CSRC approval are, among others, in the Special Regulations of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares, issued by the State Council on 4 July 1994.[72] By mid-2007, the number

69 The Hong Kong Stock Exchange, the Hong Kong Securities and Futures Commission, and the CSRC entered into a Memorandum of Regulatory Co-operation on Regulation of Mainland Enterprises Listed in Hong Kong on 19 June 1993.

70 Li Zhangzhe, *Finally Successful: The Report of the Development of Chinese Share Market*, 270-271. Other eight companies were Shanghai Petrochemical Co., Ltd., Beiren Printing Machinery Holdings Ltd., Guangzhou Shipyard International Co., Ltd., Maanshan Iron and Steel Co., Ltd., Kunming Machine Tool Co., Ltd., Yizheng Chemical Fibre Co., Ltd., Tianjin Bohai Chemical Industry (Group) Co., Ltd., and Dongfang Electrical Machinery Co., Ltd.

71 H-shares were initially approved in 'batches'. The approval authority released the list of the successful applicants for listing approval periodically. By the end of the 1990s, applications were reviewed and decided upon separately rather than in batches.

72 Also, the Special Assessment Guidelines, the most recent of which were issued by the State Council on 14 July 1999 and 21 September 1999, also regulate the listing of Chinese companies on Hong Kong's main board and growth enterprise market.

of Hong Kong-listed Chinese companies rose to 143, 35 of which had domestic A-shares listed on one of the mainland stock exchange.[73]

The price gap between domestic and foreign share values of dually listed Chinese companies has narrowed in recent years, from 380 per cent in 2001 to about 30 per cent at the end of 2005.[74] The price gap was once the most difficult challenge to overcome for a dual listing of the company as the PRC Company Law contains a 'same share same rights' principle. The technical solution to this challenge is to stagger the listing of the same company in Hong Kong, usually several to 12 months after the listing in China first.

The applicant enterprise must also satisfy Hong Kong legal requirements in order to be listed in Hong Kong. For instance, the listing company must amend the articles of association in accordance with the Hong Kong Companies Ordinance. A listing application must be submitted to the Hong Kong Stock Exchange. Hong Kong listing requirements must be satisfied.

An H-share company may be also subject to the *de facto* control of its parent company, which often is an unlisted or listed state-owned enterprise in China. Some subsidiaries of state-owned enterprises have been trying to spin off from their parent companies and list in Hong Kong. The CSRC in August 2004 released the Certain Issues Concerning the Regulation of Offshore Listing of Subsidiaries of Domestic Listed Companies Circular Number to regulate the spin-off listing in Hong Kong by the PRC-listed companies.

Accordingly, a listed Chinese company can apply to the CSRC for the listing of a subsidiary in Hong Kong. The major concern of the CSRC is that a minimum level of value still remains with the parent company after the spin-off. For instance, the entitlement of the listed parent company to the distribution of the net profit of the controlled subsidiary should not account for 50 per cent or more of the total net profit of the listed parent company reflected in its consolidated financial statements. The entitlement of the listed parent company to the net assets of the controlled subsidiary should not account for 30 per cent or more of the total net assets of the listed parent company reflected in its consolidated financial statements.[75]

Red Chips. Some companies incorporated in Hong Kong are funded by the Chinese government. These companies are generally termed as 'window companies' of the Chinese government. The shares of these companies are called 'red chips'. The issuance of shares by these companies must comply with Hong Kong law rather than Chinese law.

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73 List of all H-share companies is available at the Hong Kong Exchanges and Clearing Ltd, see http://www.hkex.com.hk (data and statistics – China dimension).

74 Weijian Shan, 'The Mystery of China's Sinking Stocks', 168(11) *Far Eastern Economic Review* (December 2005) 5, 6.

75 The Certain Issues Concerning the Regulation of Offshore Listing of Subsidiaries of Domestic Listed Companies Circular Number, Section 2.

N-Shares. N-shares are the shares that are listed by Chinese companies on the New York Stock Exchange to foreign investors.[76] N-shares are denominated in Renminbi but traded in United States dollars. The first N-shares were issued by Shenyang Jinbei Automobile Company through one of its controlled companies. N-shares also may be issued through American Depository Receipts.

Bonds. Apart from A-shares and B-shares, bonds are traded on the two domestic stock exchanges. Bonds include corporate bonds, treasury bonds repurchases, convertible bonds, financial bonds, construction bonds, and state treasury bonds (T-bonds).

Treasury bonds are securities with fixed interest rates, issued by the Ministry of Finance, and are floated to cover budget deficits as well as to raise funds for large construction projects. The issuance of state treasury bonds is subject to a quota issued by the Ministry of Finance each year with the approval of the State Council.[77] The term of state treasury bonds vary from 20 years, 10 years, eight years, five years, three years, and one year to six months, which provides more flexibility and incentives to investors.

The state treasury bonds market was further opened in 1988 with non-financial institutions being underwriters, [78] and being traded over the counter. Construction bonds are issued by the Ministry of Finance to finance major construction projects or infrastructure projects.[79] Financial bonds are issued by banks and other non-banking financial institutions as an additional source of funds and are usually used for specific financial projects.

Corporate bonds are issued by trading enterprises to supplement their general capital needs.[80] The first batch of enterprises issued corporate bonds in 1984.[81] The term of corporate bonds is often shorter. The bonds are usually available to Chinese investors who reside in China. Overseas Chinese are not eligible to invest in bonds.

Funds. Funds appeared before the emergence of B-shares. China Oriental Company set up the China Oriental Fund in Hong Kong and London in December 1985.[82] Bank of China and China International Trust and Investment Corporation set up mutual funds in 1987.[83]

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76 Zhou Yousu (ed), *General Theories on Securities Law* (in Chinese) (Chengdu: Sichuan People's Press 1999) 94.

77 Regulations on State Treasury Bonds of the State Council 1992, art 4.

78 R Nottle, 'The Development of Securities Market in China in the 1990s', (1993) *Company and Securities Law Journal* 11(8), 504.

79 The State Economic Construction Bonds Regulations were issued on 9 December 1953.

80 China International Trust and Investment Company issued corporate bonds in 1982.

81 Zhou Yousu (ed), *General Theories on Securities Law* 113.

82 Jin Dehong, *Contemporary Securities Market of China*, 120.

83 Zhang Zhenlong (ed), *A Concise History of Chinese Securities Development*, 285.

The early stage of mutual funds was on a small scale with the aim of attracting foreign investment.[84] The first fund targeting domestic investors was set up in July 1991 with the approval of the Shenzhen Branch of the People's Bank of China.[85] More than twenty funds, open-ended or close-ended, were launched for the wide institutional and retail investors in 1992.[86] The fund management companies are set up by the government.

Issuance of Shares

The first regulations at national-level regulating the formation of and issuance of shares by joint-stock companies was the Standard Opinion for Joint Stock Limited Companies, issued by the State Council Restructuring Commission on 15 May 1992. The issuance of shares by a joint-stock company is now subject to both the Company Law and the Securities Law. One thing in common under these two laws is the government's involvement.

Under the Company Law, the establishment of a joint-stock company must be approved by the competent government authority under the State Council or a local government.[87] Under this system, the government controls the number and type of the enterprises that could issue shares to the public and list in the stock market. The quota system not only reflects the cautious attitudes of the government towards growing the securities market but also the feature of the planning economy where China's economic reform started from. The State Development Planning Commission maintained an annual national shares issuing scheme, which set out the total number of shares to be issued, the types of shares, the category of issuers, and the way to issue shares.[88]

The quota was then allocated among ministries, at the central level, and provincial governments, at the local level.[89] The ministries and local governments selected SOEs and recommended them to the State Development and Planning Commission. A company which wants to issue shares to the public market must apply to the relevant authority. In this process, it was up to local leadership to determine which firm can be listed. Although some performance tests must be satisfied, the authorities' selection was largely politically driven and bore little resemblance to market forces. The local government may have used scare quotas for companies which were caught with financial difficulties (other than being financially healthy) or economically important to the local economy. The CSRC conducted the final review of these recommended ones and decided what shares could be issued.

84 Zhang Zhenlong (ed), *A Concise History of Chinese Securities Development*, 285.
85 Zhang Zhenlong (ed), *A Concise History of Chinese Securities Development*, 285.
86 Jin Dehong, *Contemporary Securities Market of China* (in Chinese), 175.
87 Company Law 1993, art 77.
88 Lin Ye, *Chinese Securities Law* (Beijing, China Auditing Press 1999) 38.
89 A. Browne, 'China Announces Stock Market Rescue, Prices Surge', *Reuter Asia-Pacific Business Report*, 14 March 1994.

The approval from the competent government authority is compulsory for the incorporation of a joint-stock company. In the approval process, the government authority will not only review the form of application documents but also the substance of the application, including the accuracy, completeness, and truthfulness of the application documents, creditworthiness, business operation, price of shares, and future of the company. The government's heavy involvement in the share issuing process was a key feature of China's securities market. The quota system, however, may not be fair to all the market players. For instance, private enterprises were placed in a more disadvantageous position due to their lack of affiliation with the central or local government, without which the quota may be difficult to be allocated to them. The quota system did not have a sufficient level of transparency and the market players were not aware of the exact thresholds which need to be satisfied in order to obtain the quota. The quota system was revoked in March 2001.

The approval and quota system only made sense when China was still in a transitional stage moving from a socialist planning economy to a socialist market economy. The Securities Law 1998 abolished the quota and approval system[90] by requiring that a share issue by means of a public offer be verified by the CSRC as well as in compliance with other requirements under the Company Law 1993.[91] This verification system 'shall be made public,[92] and shall be subject to supervision according to law'.[93] In practice, the verification system subjects the new issuance of shares to an initial review of the application by the Public Offering Supervision Department of the CSRC, and a subsequent review by the Share Issue Examination and Approval Committee (or sometimes translated as Public Offering Review Committee) under the CSRC.[94] The Committee is composed of 25 members, and the CSRC's chief investigator, chief counsel, chief accountant, and the general managers of the Shanghai and Shenzhen Stock Exchanges are automatic members.[95]

Other members in the Committee are drawn from a wide range of interest groups including government agencies, financial intermediaries, institutional investors, stock exchanges, academic institutions, and overseas professionals.[96]

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90 CSRC issued a Circular Number in June 2000 calling for the use of 1997 quota until it was used up. See CSRC, Circular Number on Relevant Issues on Year 1997 Share Issue Quota, 7 June 2000.

91 Securities Law 1998, art 11.

92 There have been no procedures for applicants to be informed of the identities of the members in the listing hearing, and the level of secrecy still surrounds the decision-making process.

93 Securities Law 2005, art 23.

94 Securities Law 1998, chapter 14; Securities Law 2005, art 22; State Council's Interim Measures on the Securities Issue Verification Committee of the CSRC.

95 State Council's Interim Measures on the Securities Issue Verification Committee of the CSRC, art 4.

96 Bei Hu, 'Mainland Reforms Listing Panel', *South China Morning Post* (Hong Kong), 12 December 2003.

Persons involved in the approval of applications to issue shares may not have a material connection with, or accept gifts from, the applicant or hold shares of the applicant or have any private contact with the applicant.[97] A recommendation will be made by the Committee to the CSRC. In most cases, the CSRC will accept the Committee's recommendation making the Committee a *de facto* decision-making body for public offering applications.

Under the verification system, the CSRC no longer reviews the substance of the application as the applicant ensures the truthfulness, completeness, and accuracy of the application documents.[98] In effect, the CSRC will only look at the forms of the application documents and then make a decision on an application. The sponsors, in order to issue shares, must provide the CSRC with the application documents, including the business operation of the company, financial report, accounting report, list of directors, creditability of key managers, the means of public offer, the price for shares, and the usage of fundraising. Although the purpose of the adoption of the verification system is to simplify the share issuing process, the share issuing system has not been streamlined due to the involvement of the CSRC and looser *de facto* use of the quota system.[99] The selection of companies to be listed is to some extent made by the state instead of the market as the CSRC may be still concerned about (i) the control over the total amount of capital raised on the market; (ii) the proportion of listed companies from different industrial sectors and localities if the listing decisions are made; and (iii) favorable market reaction to the listing of companies. Consequently, the process probably becomes more complicated than before, and the selection of companies to be listed publicly is still to some extent made by the state other than the market.

The applicants and the public are protected by the Securities Law in that the CSRC must reach a decision on listing applications within three months from receiving the listing application documents; and in, addition, that reasons must be given if an application is rejected.[100] Nevertheless, the applicant or the public does not have any avenue for complaint if the CSRC rejects the application.[101]

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97 Securities Law 2005, art 23.

98 Securities Law 1998, art 13.

99 Securities Law 1998, art 11.

100 Securities Law 2005, art 24.

101 The Administrative Law may make the CSRC accountable for its listing decisions. Under the Administrative Law, companies are more able to launch administrative litigations against the CSRC. The CSRC lost a lawsuit to Hainan Kaili Central Development & Construction Co. in 2000 for the CSRC's rejection of its listing application from 1998. Beijing Number 1 Intermediate Court ordered the CSRC to re-review the company's listing application within two months. Mathew Miller, 'Hainan Construction Company Wins Landmark Case Against CSRC', *South China Morning Post*, 20 December 2000; Bei Hu, 'Regulator Fights Ruling', *South China Morning Post*, 6 January 2001; Bei Hu, 'Narcissus Shareholders Sue CSRC, Shanghai Exchange Over Delisting', *South China Morning Post*, 27 April 2001.

This, however, may not be unusual as, for example, the Hong Kong Stock Exchange rarely provides any reasons for its decisions on listing-related matters.

The CSRC issued the new Measures on the Public Offering Review Committee, which came into effect on 9 May 2006, and outlined a three-stage approval process. In the first stage, the sponsor files the application documents and the CSRC's Issuance Department preliminarily examines and verifies the application documents. The second stage involves an *ad hoc* meeting by an issuance verification commission consisting of seven members, who examine the application documents prepared by the issuer, lawyers, accountants, financial advisers, and valuation institutions. The last stage is that the CSRC will make a final decision based on the recommendation made by the commission.

The new Measures for the Administration of Initial Public Offerings of Shares and the Listing thereof were issued and became effective on 18 May 2006 with the key purpose of reshaping the shareholder structure of the listed companies. Meanwhile, the new listing rules were issued by the Shanghai and Shenzhen Stock Exchanges to implement the new Measures as well as the Company Law and Securities Law. Under the new Measures, the minimum registered capital requirement for listed firms remains at RMB 50 million, which must be paid up before the listing.

25 per cent of the issuer's total issued share capital is a minimum public float for the most listed companies. However, for the listed company with a total share capital of more than RMB 400 million, the standard for a minimum public float is changed from 15 per cent to 10 per cent of the total share capital. According to the new Measures, the issuer should be independent from its controlling shareholder and other companies controlled by that shareholder, in respect of its ownership of operating assets, financial system, personnel, business system and organization.

Issuer Requirements

- In order to issue shares by public offer, a company must satisfy the following conditions:
- Production and management of the company must conform to the industrial policies of the state;
- Only one kind of ordinary shares may be issued with equal shares for equal shares;
- The promoter's share capital may not constitute less than 35 per cent of the total share capital;
- The promoter's shares may not be less than RMB 30 million of the total shares issued by the company, except otherwise provided for by the state;
- The shares offered to the public may not be less than 2five per cent of the total share capital to be issued. Of these shares, the company employee-owned shares may not exceed 10 per cent of the number to be issued to the public; if

the total number of shares to be issued is in excess of RMB 400 million, the CSRC may reduce the portion to be issued to the public; however, the minimum portion must be more than 10 per cent of the total shares;

- The promoters have no major violations of the PRC law in the past three consecutive years; and
- Other requirements set by the CSRC must be met.[102]

These requirements are applicable to the incorporation of new joint-stock companies. For an SOE to be transformed to a joint-stock company, the following requirements must be satisfied:

- The net assets account for more than 30 per cent of the total assets and the intangible assets account for no more than 20 per cent of the net assets at the end of the year prior to the year when the issue takes place, except otherwise provided for by the CSRC;
- The company has been making profits for three consecutive years; and
- Other requirements provided for by the CSRC must be met.[103]

Prospectus Requirements

The issuer needs to publicize the prospectus when issuing new shares[104] as well as the share listing notice. As far as the content and format of prospectus are concerned, the CSRC issued Rule Number 1 on Content and Format of Prospectus, which set out a standard format for a prospectus:

- The cover page of a prospectus, the catalogue of a prospectus, the appendix, a reminder of reading the auditing report, and interpretations of key concepts;
- Names of the issuer, shareholders, and purpose of share issue;
- General information about the issuing, such as the classification of shares, the issuing price, and the face value per share; the shareholding structure of the company; the usage of the capital to be raised; and distribution of profits;
- Investment risks;
- Detailed information about the issuer;
- The scope of business and technical support;
- Competition and related party transactions;
- Details of directors, supervisors, senior managerial staff, and major technical staff;
- Corporate governance scheme;
- Accounting and finance information;

102 The Interim Regulations on Administration of Share Issues and Trading of 1993, art 8.

103 The Interim Regulations on Administration of Share Issues and Trading of 1993, art 9.

104 Company Law 2005, art 135.

- Targets of the company;
- Proposed use of the raised capital;
- Share issuing price setting and profits sharing policy; and
- Statement of directors, accounting firm, law firm, and assets appraisal firm.

Trading Rules

Procedure for IPOs. National level rules governing the issue and trading of domestic A-shares were the Administration of the Issuing and Trading of Shares Tentative Regulations, promulgated by the State Council on 22 April 1993. The current procedure for IPOs is outlined in the CSRC's Procedures for Verification of Share Issue 2000. A company needs to follow a five-step in order to be listed:

- The company must prepare and submit application documents to the CSRC after obtaining the approval from the provincial or ministerial authority. The CSRC will make a decision on whether to accept or reject the application within five working days after the application is lodged.
- The CSRC will have a preliminary review of the application documents after the application is accepted. A preliminary review opinion will be notified to the company and its underwriter within 30 days of accepting the application. The applicant may have to submit supplementary application materials. The CSRC may seek opinions from the State Development Planning Commission (the predecessor of the State Development and Reform Commission) and the State Commission of Economics and Trade (which was later merged into the Ministry of Commerce).
- The CSRC will transfer the application documents and its preliminary review results to the Share Issuing Verification Commission within 60 days after the acceptance of the application documents.
- The Share Issuing Verification Commission makes the decision on whether or not the share issue application is verified with reasons within three months after the application documents are received.
- The applicant whose application has been rejected may apply for an administrative review of the decision by the Share Issuing Verification Commission within 60 days after receiving the written decision. The CSRC should make a decision on whether an administrative review is to be conducted within 60 days after receiving the review application.

This five-step procedure is still time-consuming and bureaucratic. The whole procedure may take 155 days, which may harm the efficiency of the IPO process. Furthermore, the Securities Law 2005 requires the applicant company to have sponsors, which was first introduced by the CSRC's Provisional Measures on Securities Issuing and Listing Sponsorship System. The Securities Law 2005 makes a list of documents the applicant must submit to the CSRC for the IPO application. Among others, a prospectus is the major disclosure document.

Securities offering may be carried out through offline placement organized and completed by the underwriters or online issuances (via the electronic system of securities exchanges). If both are used, they should be conducted simultaneously.[105] This requirement may guarantee the equal access to the securities market by individual investors.

When the distribution of domestic A-shares is made through the securities companies, underwriting agreements should be signed for a period of no longer than 90 days.[106] An underwriting agreement can be either a 'firm commitment underwriting agreement' or a 'best efforts underwriting' agreement.[107] Securities underwritten on a best efforts or firm commitment basis must be first sold to subscribers and should not be set aside or retained by underwriters. Securities offered to the public with a total face value exceeding RMB 50 million must be distributed by a distribution syndicate comprising a securities company as the chief underwriter and participating security companies.

The follow-on issues are now mainly regulated by the Measures for the Administration of Securities and Offerings by Listed Companies, effective as of 8 May 2006. The follow-on issues offer the listed companies more funding options via private placements and secondary sales to the public. Consequently, the listed companies may increase the size of outstanding shares.

The follow-on issue may be subject to some restrictions. For instance, when a follow-on public offering is made to existing shareholders, the value of the issued shares should not exceed 30 per cent of the issuer's share capital. The issue price of shares in a follow-on issue should not be less than the average of the issuer's shares in the 20 trading days prior to the publication of the prospectus.

The CSRC on 8 May 2006 issued the revised versions of some guidelines on the format and content of application documents and prospectuses for public offerings of shares: ie, Listed Companies Public Offerings Information Disclosure Contents and Formats Guidelines Number 10 and 11; Guidelines for the Contents and Formats for Information Disclosure by Companies That Offer Securities to the Public (Number 10); Application Documents for Public Offers of Securities by Listed Companies; Guidelines for the Contents and Formats for Information Disclosures by Companies That Offer Securities to the Public (Number 11); and Prospectus for Public Offers of Securities by Listed Companies.

As far as the private placement is concerned, a listed company issues shares to a limited number of designated investors.[108] Although no formal offer document is

105 Measures for the Administration of the Offering and Underwriting of Securities, art 31.

106 Securities Law 2005, art 33.

107 Securities Law 2005, art 28.

108 Measures for the Administration of Securities Offerings by Listed Companies, arts 36–39.

required for a private placement, there is supposed to be a private placement memorandum. The requirements are less stringent than those applicable to public follow-on offerings. For example, no qualification requirements are imposed on designated investors to a private placement except for 'foreign strategic investors'.[109] New shares issued through private placement are subject to a one-year lock-up period. The period will be extended to three years if new shares are subscribed for by a controlling shareholder or a *de facto* controller.

The issue price of the newly issued shares should not be less than 90 per cent of the average price of the issued shares within the last 20 transaction days before the date of pricing.[110]

Application Documents for IPOs. For the purpose of public share offerings, the issuer must submit application documents and other supporting documents to the CSRC as follows:

- Application for share issue;
- The resolution of the promoter's meeting, or the shareholders' meeting on share issue by public offer;
- The approval documents of establishment of the joint-stock company;
- The business license or the establishment registration of the issuer granted by the Administration of Industry and Commerce;
- The articles of association or the draft articles of association of the joint-stock company;
- The prospectus;
- A feasibility study report on utilization of the funds and documents of approval issued by the relevant government departments concerning investment projects on fixed assets;
- The company's financial report for the last three years or since its establishment, which has been audited by an accounting firm, and the auditing report which has been signed by two registered accountants and sealed with the seal of the accounting firm;
- Legal opinions signed by at least two lawyers and sealed by their law firm;
- An assets appraisal report signed by at least two professional appraisal personnel and sealed by their offices, a capital rating report signed by at least two registered accountants and sealed by their offices, and the confirmation

109 The qualification requirements for a strategic foreign investor are imposed in the Measures for the Administration of Strategic Investments in Listed Companies by Foreign Investors. Accordingly, an investor must comply with quantitative requirements (owning at least US $100 million of offshore assets or managing at least US $500 million of offshore assets; obtain an 'in principle' approval from the Ministry of commerce prior to subscribing for new shares issued through the private placement; and satisfy a range of prudential conditions.

110 Measures for the Administration of Securities Offerings by Listed Companies.

document by the state assets management department if state-assets are involved;

- The underwritten plan and the underwriting agreement; and
- Other documents required by the CSRC.[111]

Price-Setting Process

The CSRC has relaxed its control over the price-setting process for new A-share issues.[112] A listing company and its lead underwriter are free to set the issue price, within the scope confirmed by the CSRC, through the book-building method.[113] This changed the previous practice prior to 1999 when private placement in conjunction with a public offering was not allowed. Under the new Circular Number on Further Improving Methods of Issuing Shares, qualifying companies are allowed to conduct A-share issues through a combination of private placement to Chinese legal persons and public offerings to ordinary investors, which has been further confirmed by the 2005 Securities Law.

Although the CSRC attempts to withhold approval for IPOs whose price falls outside permissible limits,[114] the problems of price instabilities and fluctuations still remain as the key method of setting the issue price is through the negotiation between the listing applicant and the securities regulatory authorities. The lack of fairness and transparency for IPO pricing was one of the factors that led to a dramatic decline in the value of the domestic stock exchanges in 2004 and the subsequent one-year suspension of new share issues and sales.

The offering and underwriting of shares, in addition to the Securities Law, is subject to the Measures for the Administration of the Offering and Underwriting of Securities effective as of 19 September 2006. The Measures represent a great effort taken by the CSRC to improve the transparency and fairness in IPO pricing. The Measures leave the pricing to be decided through a two-stage pricing inquiry process via qualified institutions (termed as 'inquiry recipients'),

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111 Company Law and Securities Law.

112 Circular Number on Further Improving Methods of Issuing Shares, issued by the CSRC on 28 July 1999.

113 Circular Number on Further Improving Methods of Issuing Shares, issued by the CSRC on 28 July 1999. By way of background, 'book-building' is a process used monthly in America under which the lead investment bank in an IPO or share placement discusses with the clients, issues a prospectus, and goes on a road-show with the transaction. Institutions are asked to make a non-binding bid for stock within a given price range. New discussions will begin after the marketing is completed. In the new round of discussions, clients, institutional investors, and other brokers may agree upon an offer price. Firm undertakings are taken at this stage, and the final price is set ahead of the transaction going forward. The final price, however, may be lower than the previously set one which may give the investors some benefits. For details, see 'A Close Look at US Book Building', *South China Morning Post*, 28 July 1993.

114 'A Close Look at US Book Building', *South China Morning Post*, 28 July 1993.

such as securities investment fund management companies, securities companies, trust and investment companies, finance companies, insurance institutional investors, and foreign institutional investors.[115] The purpose of designing this process is to improve the weaknesses and shortcomings of such mechanisms as fixed pricing and price-earnings-based pricing. The first stage of the pricing inquiry process is the preliminary inquiry which will determine the offer price range.

The second stage is book-building, that is, the determination of the specific offering price. In IPOs involving more than 400 million publicly offered shares, at least 50 inquiry recipients should participate and provide valid quotations. If the IPOs involve fewer than 400 million publicly offered shares, the number of inquiry recipients is at least 20. An inquiry recipient is not allowed to participate in the initial price inquiry or off-line placement if it has not participated in the initial price inquiry or if it did not make a valid quotation notwithstanding its participation in the initial price inquiry.[116] The issuing price is usually determined through negotiations between the underwriter and issuer.[117]

In order to maintain the price stability, the listing rules of Shanghai and Shenzhen Stock Exchanges extend the lock-up period for general shareholders to 36 months whenever an IPO takes place. As far as the general shareholders (who acquire the shares within 12 months prior to the IPO) are concerned, the lock-up period commences from the date on which the shareholder is registered as a shareholder of the issuer. To the controlling shareholders, the lock-up period begins on the listing date. The signing of the lock-up agreement is one of the conditions to the approval for IPO.

B-Share Issuing Procedure

B-shares were once only available to foreign companies, foreigners, and companies and residents from Hong Kong, Macau, and Taiwan. The primary purpose of issuing B-shares is to attract foreign capital. Chinese citizens living inside China are allowed to invest in B-shares from February 2001. In this sense, there is no longer a difference between A and B-shares. The governing legislation as to the issuance of B-shares is the State Council's Provisions Concerning Listing of Foreign-Invested Shares by Joint-Stock Companies Inside China of 1995 and its Implementing Rules Concerning Listing of Foreign-Invested Shares by Joint-Stock Companies of 1996. The requirements for incorporating a company by public offer of B-shares are:

- The capital to be raised by B-share offers must be used in line with state industrial policies;

115 Measures for the Administration of the Offering and Underwriting of Securities, art 5.

116 Measures for the Administration of the Offering and Underwriting of Securities, art 30.

117 Securities Law 2005, art 34.

- B-share issue must comply with the state regulation on fixed-assets investment;
- At least 35 per cent of the shares to be issued should be subscribed for by the promoter and at least RMB 150 million of total capital must be invested by the issuer;
- The shares to be issued to the public must account for 25 per cent or more of the total capital. The percentage can be lowered to 15 per cent if the share capital is more than RMB 400 million;
- The company has not conducted any illegal acts in the past three consecutive years; and
- The company has made profits in the past three consecutive years.

The procedure of issuing B-shares is as follows:

- The issuer lodges an application to the local government or central government and has recommendation to the CSRC from either the local government or the relevant department of the central government. However, it is not clear when the application should be submitted to the central level.
- If the face value of the proposed shares is less than US $30 million, the issue of B-shares needs to be approved by the CSRC. If the face value is more than US $30 million, the issue application must be lodged with the CSRC and then passed to the State Council by the CSRC for approval.[118]
- The total number of B-shares to be issued should be within the quota.
- The CSRC and other departments under the State Council select and approve companies for B-share issuance.
- The company approved to issue B-shares must submit the prescribed documents to the CSRC for verification. It is not clear why this verification is necessary as the company is first approved and selected by the CSRC anyway.

The approval process requires the company to submit the following documents:

- The application report;
- The name of the issuer, the number of shares subscribed for by the issuer, the types of investment and the capital verification report;
- The resolution of the promoters in favor of B-share issue;
- The approval document of the State Council authorized department or the local government;
- The recommendation by local government or the department in charge of enterprises under the State Council;
- The approval notice of the enterprise named by the State Administration of Industry and Commerce;

118 State Council, Provisions Concerning Listing of Foreign-invested Shares by Joint-Stock Companies Inside China 1995, art 2.

- The draft articles of association;
- The prospectus;
- The report of feasibility of capital use;
- The financial reports of the enterprise in the past three years which are audited by a registered accountant and his accounting firm;
- An asset appraisal report signed by two professional appraisers and their institutions; if state-owned assets are involved, confirmation and approval documents on state-owned equity issued by the State Assets Supervision and Administration Commission (SASAC) must be provided;
- A legal opinion on relevant share issues signed by two or more lawyers and sealed by their firm;
- An underwriting proposal and underwriting agreement on B-share issue; and
- Other documents required by the CSRC.[119]

The approval process outlined above is complicated and time consuming. The heavy involvement of government authorities is clearly seen in this process. The government's participation in this process seems to suggest that the securities market as a whole is still in infancy. Regardless of the discretion the government authority may exercise, the approval process adds transactional costs to the listing activities in China. In a long run, drawing on experience from other jurisdictions, the level of involvement by the state and government authorities should be gradually reduced and let the market play an adjusting role in the market.

Securities Industry

Market Structure

Securities Companies

There are two types of securities companies in China: comprehensive securities companies and brokerage securities companies. A comprehensive securities company is allowed to carry out a range of services, including securities brokerage business, proprietary trading, underwriting of securities, securities investment consulting, and investment management, and its minimum registered capital requirement is RMB 500 million. A brokerage securities company is only allowed to conduct securities brokerage business and its minimum registered capital requirement is RMB 50 million.

The Securities Law makes it clear that securities business should be operated and managed separately from banking, trust, and insurance business. In other words, securities companies should be incorporated independently from

119 State Council's Provisions Concerning Listing of Foreign-invested Shares by Joint Stock companies Inside China 1995, art 11.

banking, trust, and insurance companies. For the time being, foreign investors are not allowed to trade in A-shares, other than via the QFII scheme. Only Chinese nationals or Chinese legal persons may open a customer's trading account with securities companies.

Apart from the prohibition on providing financing and stock lending services to clients, securities companies also are prohibited from managing discretionary accounts under which the securities companies decide the quantities and prices of securities transactions for their clients, and from making any promise as to the losses or gains from securities transactions. Securities companies are only allowed to buy and sell securities on behalf of their clients in accordance with clients' instructions relating to the quantities and prices of shares. In addition, securities companies which are to engage in proprietary trading must separate their proprietary accounts from their brokerage accounts and must enter into securities transactions in their own name. They cannot conduct proprietary securities transactions using other persons' names. The securities companies, whether engaging in proprietary trading or brokerage trading, are prohibited from disposing of the securities which they have acquired on the same date.

The securities companies are required to contribute to a Transaction Risk Fund from their after-tax profit. In addition, the securities companies are required to comply with certain financial indicators, including meeting a prescribed ratio between current liabilities and assets. The CSRC has not yet specified the percentage of contribution and the ratio. Under the QDII regime, the QDII seems to be allowed to manage discretionary accounts on behalf of clients provided that it ensures the quality of transactions including but not limited to seeking the best transactions and proceeding accordingly, endeavouring to minimize transaction costs, and using the holders' trading commissions to procure returns for the holders.

Joint Venture Securities Companies

Foreign securities firms are now permitted to joint venture with Chinese securities companies or to acquire a stake in Chinese securities companies. The qualification requirements on the foreign shareholder are as follows:

- Its securities regulatory body has signed a memorandum of understanding with the CSRC with respect to co-operation in the area of securities regulation and has maintained an effective regulatory co-operative relationship;
- It is a securities firm licensed to conduct securities business in its country of incorporation and has been operating in the financial sector for more than 10 years;
- It has not been subject to any material sanction imposed by a securities regulatory body or judicial department during the past three years;
- The various risk control targets for the past three years have met the legal requirements and the requirements of the securities regulatory body of the country of its incorporation;

- It has a sound internal control system;
- It has a good reputation and good business achievements in the international securities market; and
- Other prudent conditions required by the CSRC.

According to the United States–PRC WTO Protocol, the criteria for the establishment of a securities joint venture may not include an economic needs test or quantitative limits. If there is only one Chinese shareholder in a securities joint venture company, the Chinese shareholder must be a domestically funded securities company. If there is more than one Chinese shareholder in the joint venture, the other Chinese shareholder does not have to be a domestically funded securities company. However, this other party needs to possess the qualifications in respect of a shareholder of a securities company as required by the CSRC. These requirements are set out in the Administration of Securities Houses Procedures, issued by the CSRC with effect from 1 March 2002.

The registered capital of a joint venture securities company must be no less than RMB 500 million. The equity interest held by the foreign party may not exceed one-third of the total registered capital of the joint venture (Article 10 of the Securities Joint Venture Rules, and the Foreign Investment Industrial Guidance Catalogue, promulgated on 11 March 2002 and effective as of 1 April 2002). The scope of business of a securities joint venture firm is limited to:

- Underwriting of shares (including A and B-shares) and bonds (including government and corporate bonds);
- Dealing in foreign investment shares (B-shares) as a broker;
- Dealing in bonds (including government bonds and corporate bonds) as a broker and for its own account; and
- Other businesses approved by the CSRC.

The approval for the establishment of a securities joint venture company involves a two-phase process. The first phase entails the filing of an application with the CSRC by a representative jointly appointed by the shareholders, the review of the application by the CSRC, a decision by the CSRC on whether or not to approve the application, and registration with the SAIC if approval is granted by the CSRC. The second phase involves the filing of an application with the CSRC for the Securities Business Operation Permit. If the CSRC does not issue the Permit, the securities joint venture company may not engage in securities business.

A foreign investor may choose to acquire a stake in an existing Chinese securities company and to apply for the conversion of the domestic securities company into a foreign investment securities company. The limitations on equity ratio, the scope of business, the qualification requirements in respect of the shareholders and the requirement of at least one domestic shareholder holding no less than one-third of the equity interest will continue to apply.

Trust Investment Companies

Under two pieces of PBOC regulations, that is, the Administration of Trust and Investment Companies Procedures (with effect from 5 June 2002) and the Administration of the Business of Holding Funds in Trust of Trust and Investment Companies Tentative Procedures (with effect from 18 July 2002), a trust investment company may launch investment funds or fund management companies, which may underwrite government and corporate bonds and may indirectly engage in the underwriting and trading of stocks. They may offer private placement financing by setting up a collective trust from 200 investors with each investor contributing no less than RMB 50,000. This 200-investor hurdle may be removed by offering more than one trust for the same purpose.

It is worth noting that the CSRC issued a circular in 2001 which permits domestic securities companies to engage in trust investment businesses. However, it is unclear whether the CSRC intends to eventually allow foreign-invested securities companies and foreign-invested fund management companies to offer these services. Under the CSRC's Establishment of Securities Companies with Foreign Equity Participation Rules effective as of 1 January 2008, a securities company offering trust investment services can only manage cash and securities, and can only invest in publicly traded securities and their 'derivatives'.

Securities Registration and Settlement Institution

The establishment of a Securities Registration and Settlement Institution must be approved by the CSRC and it must have a minimum of RMB 200 million self-owned capital. The functions of such institutions are:

- Establish securities accounts and settlement accounts;
- Undertake custody and transfer of securities;
- Register holders of securities;
- Clear and settle securities listed on the securities exchanges; and
- Distribute rights and entitlements in respect of the securities as entrusted by the securities issuers.

These institutions are not allowed to lend or pledge the securities of clients to third parties and are required to maintain original documents in relation to the registration, custody, and settlement of securities for a period of 20 years. A Clearing Risk Fund needs to be established by such institutions for compensating losses and damages arising from technical problems, mistakes in operations, and *force majeure* events. The Clearing Risk Fund is to be collected from the income of the institutions and levied as a certain percentage of the transaction volume of securities companies, and allocated to a separate account.

Securities Transactions Services Institutions

The Securities Law provides for the establishment of securities investment consultancy institutions and credit rating institutions. The CSRC has not yet set out detailed requirements and procedures for the establishment and operation of these institutions. On the other hand, it is clear that the personnel of securities investment consultancy institutions are prohibited from:

- Investing in securities as agents;
- Making any commitment or undertaking as to the sharing of gains or losses resulting from securities investment; and
- Buying and selling securities of companies to which their employer consultancy institutions have provided services.

Securities Investment Funds

The Securities Investment Funds Law still distinguishes between closed-end and open-ended funds whilst holding open the possibility that funds in other forms may be possible in the future. Closed-end funds are funds that exist for a fixed term and that permit no additional investment beyond a pre-determined amount. In 2001, open-ended funds were launched. Like mutual funds in the United States, an open-ended fund allows new investors to participate in the funds at any time, without limits on the maximum capital or participation time frame of a particular fund. Among the 87 approved funds by 2004, around 54 were closed-end funds, most of which were listed on the PRC stock exchanges.

Both types of funds have a fund manager who organizes establishment of the fund and makes investment decisions within the range in accordance with PRC law and fund contracts. A fund custodian handles fund assets and executes the instructions of the fund management company concerning investments. Fund management companies may appoint the CSRC-approved sales agents to handle subscriptions, redemptions, and record keeping concerning individual investors.

A fund management company must have at least RMB 100 million in registered capital. The principal shareholder must have at least RMB 300 million in registered capital and experience in the financial sector. Fiduciary duties are imposed by Chinese law on fund management companies and custodians.

The function of a fund management company is to manage capital but not to provide it. Funds assets must be invested in accordance with the fund contract, but special allocations are not mandated. Fund investments are confined to listed company stocks and bonds. The funds are not allowed to invest in other funds, which suggests that the fund of funds (FoF) is not allowed in China. The State Council is empowered to alter this prohibition. However, the QDII regime has rendered such prohibition on investment by PRC funds in offshore funds under the Securities Investment Funds Law meaningless.

The CSRC and the CBRC share oversight of fund custodians, which must be commercial banks (Article 25 of the Securities Investment Funds Law). The

CSRC plays a more important role in the funds sector. For instance, the CSRC is authorized to investigate and adjudicate violations of the law. In addition, the CSRC has approval authority over the licensing of fund management companies and appointing executives to fund management companies and custodians.

Securities Trade Association

The function of the Securities Trade Association is to assist the CSRC by educating and organizing its members in compliance with securities regulations, reflecting the demands and interests of its members, facilitating exchanges between the members, resolving disputes among members and between members and their clients, researching the development and operations of the securities industry, and disciplining members violating laws and regulations.

Financial Futures Industry

The modern history of financial futures in China dates back to 1993, when the Shanghai Stock Exchange introduced futures contracts in China's treasury bonds. Following a period of aggressive growth and a series of market abuse, the number of futures exchange plummeted from over 40 to just three, the Shanghai Futures Exchange, the Dalian Commodity Exchange, and the Zhengzhou Commodity Exchange, each engaged only in the trading of commodity futures. The CSRC's Measures for the Administration of Futures Companies effective on 5 April 2007 represents an important step forward in regulating China's futures industry.

Although the 'Industrial Guidance Catalogue for Foreign Investment' 2007 has removed 'investment in futures companies' from the 'prohibited' category and placed it under the 'restricted' category, which suggests that with the requirement that any foreign investment in a futures company in China be subject to the majority shareholding of the Chinese party(ies), the Futures Companies Measures do not allow foreign investment in futures companies in China, except for those from Hong Kong and Macau. The Futures Companies Measures explicitly require shareholders of a futures company to be a China-incorporated entity, except for investors from Hong Kong and Macau, who are allowed to have up to a 49 per cent interest in a futures company in China.

Trading of Securities

According to the Securities Law, only spot securities may be traded and futures trading is not permitted. Securities companies are prohibited from providing financing and stock lending to their customers. Employees of the CSRC, securities exchanges, securities companies, securities registration, and clearing institutions are prohibited from directly holding or dealing in shares, or accepting gifts of shares from other persons. These employees also are prohibited from holding or dealing in shares in the names of other persons. Any trust arrangements by the employees on these aspects are illegal under the Securities Law.

A shareholder of a company limited by shares is required to report to the company if its shareholding amounts to five per cent of the issued shares of the company. Upon receiving the report, the company may notify the CSRC and the relevant securities exchange (if the company is a listed company). If that shareholder purchases or disposes of shares in the company and sells or repurchases these shares within six months thereafter, the profits generated from such sale and purchase belong to the company and the board of the company is responsible for recovering the profit from the shareholder. If the board does not recover the profit from the shareholder and a loss to the company results, the directors may have to compensate the company. This restriction does not apply to securities companies which acquire five per cent or more of the shares in the company as part of an underwriting arrangement for the securities of the company. The approach outlined above was adopted to attack speculative trading of shares but is restrictive and may have the effect of discouraging *bona fide* transactions.

Disclosure

In General

The primary goal of securities regulations is to achieve transparency of the securities market. The basic economics theory supports the view that better protections can be provided to the investors if all the aspects of the securities market are fully and fairly disclosed. Therefore, one key aspect of the securities regulations is to ensure accurate and full disclosure of relevant information. The investors therefore are able to make informed decisions.

The Chinese laws and regulations conventionally placed more emphases on the requirements for securities issuing and the liabilities for contravention of these rules. The first piece of legislation addressing the issue of disclosure is the Provisional Regulations on the Administration of Share Issue and Trading 1993, which, however, only embodied a few general provisions concerning information disclosure.

Duty of Disclosure

It was not clear who owes the duty of disclosure, either the company or the directors or both, under the Chinese law before the Criminal Law was amended in 1997. For instance, the Company Law 1993 only refers to the duty of disclosure to the company rather than to the directors, officers and supervisors.[120] No authoritative literature can be found to explain why this legislative or regulatory loophole came into play. This loophole was filled in by the Criminal Law (amended in 1999), which, for example, provides that companies making omissions or making false statements in the prospectus, the subscription of shares, or the materials in bonds issuing be fined 1 per cent to five per cent of the illegally raised funds; and that individuals engaged in the

120 Company Law 1993, arts 140, 153, and 156.

same conduct be penalized for imprisonment of no more than five years or detention.[121]

The companies and directors with inside information leaking such information which fundamentally affects the prices of securities and causes serious effects will be subject to detention or imprisonment of no more than five years.[122] In addition, these companies and directors will be fined between one to five times the amount of the illegal gains made through this conduct. In more severe circumstances, they will be sentenced to imprisonment of between five and ten years and will be required to pay a fine between one and five times the amount of the illegal gains from their misconduct. The amended Criminal Law imposes the penalty of imprisonment or detention on the directors if they are involved in the information leakage. The Company Law 2005 further confirms the general principle that both the company and directors are liable for the leakage of sensible information to the market. Compensatory liabilities, for instance, are imposed by the amended Company Law 2005 on the company directors and other senior managers for breaches of laws and rules when the company violates laws and rules.[123]

The CSRC issued the Provisional Enforcement Rules of Information Disclosure by Listed Companies in 1993. This piece of regulations primarily deals with the content and format of information disclosure by a listed company.[124] Among others, it laid down the principle that both the issuing company and the directors of the company must ensure that no false or seriously misleading information or gross omission is in disclosure documents, the failure of which will make both the company and directors jointly liable for violations.[125] These early attempts of the CSRC indicated it pays great attention to information disclosure while it continuously administers and standardizes securities transactions and markets. The information disclosure regime, after almost 20 years' development, is now in a relatively stable shape. By mid-2009, the CSRC in total released 29 pieces of rules dealing with the content and form of information disclosure.

Major Disclosure Laws, Regulations, and Rules

Company Law. The Company Law 1993 was the first piece of national law regulating limited-liability companies and companies limited by shares. As the key purpose of the legislation is to lay down a foundation for the modern enterprise system reform, most provisions in the Company Law 1993 are more about the formation, operation, and termination of companies.

121 Criminal Law 1997, art 160.
122 Criminal Law 1997, art 180.
123 Company Law 2005, art 150.
124 CSRC released Provisional Rule Number 1 on the Content and Form of Information Disclosure – Content and Form of Prospectus in 1993.
125 CSRC's Provisional Enforcement Rules of Information Disclosure by Listed Companies (1993), art 5.

There were only a few provisions requiring a listing company to satisfy the prospectus requirement. Even with the prospectus provision, no operative criteria for disclosure were outlined.[126]

Securities Law. The Securities Law 1998 was the first national law incorporating clear disclosure rules even though it was passed 10 years after the launch of the stock exchanges in China. The Securities Law was further amended in 2005.

The Securities Law 1998 prohibits fraud, insider trading, and securities manipulation.[127] The issuer is required to publish share issuing documents by public notice and display these documents at public places.[128] The share issuing documents should be true, precise, and complete.[129] The underwriter is under legal obligation to examine the authenticity, precision, and completeness of the issuing documents.[130] Disclosures should be timely and made in a manner prescribed by application laws and regulations.[131]

The continuous disclosure, as a concept, appears first in the Securities Law 1998,[132] which is materialized in the requirement of the issuing company's presenting an annual report,[133] a half-yearly report,[134] and an interim report.[135] However, these requirements may be difficult to be implemented. For instance, an interim report is required when a listed company is in any major event that may materially affect the share price of that company to the CSRC, the relevant stock exchange, and the public.[136] However, the Securities Law 1998 does not define 'major events', which leaves loopholes to the listed companies for compliance. In addition, there is no timeline for timely disclosure.

Criminal Law. Criminal punishment of securities-related offences was introduced into the Criminal Law in its 1997 amendments, which contain some articles that impose criminal liabilities on companies and their employees who are directly involved in various forms of securities fraud.[137]

Accordingly, companies and individuals that have omitted material information or made false statements in the prospectus or the subscription of shares will be heavily fined; individuals who have engaged in the same type of conduct and are

126 Company Law 1993, art 140.
127 Securities Law 1998, art 5.
128 Securities Law 1998, art 17.
129 Securities Law 1998, art 13.
130 Securities Law 1998, art 24.
131 Securities Law 1998, arts 61, 62, 110, and 177.
132 Securities Law 1998, s 3 of ch 3.
133 Securities Law 1998, art 61.
134 Securities Law 1998, art 60.
135 Securities Law 1998, art 62.
136 Securities Law 1998, art 62.
137 Criminal Law 1999, arts 160 and 161.

directly in charge of company business will be given detention or imprisonment of up to five years.[138]

Those with inside information who leak information and materially affect the prices of securities and cause serious effects will be sentenced to detention or an imprisonment of up to five years. They will be fined between one to five times the amount of the illegal gains made by this conduct. The penalty of imprisonment or detention applies to the individuals who are responsible for a company's affairs, including company directors. The conduct of forging and passing false information affecting securities transactions will be fined between RMB 10,000 to 100,000, and the individuals involved will be given criminal detention or imprisonment of up to five years, and/or a fine between RMB 10,000 to 100,000.

The imprisonment will increase to five to 10 years, and a fine between RMB 20,000 to 200,000 in very severe circumstances.[139] While the imprisonment may be a severe punishment, the amount charged on the liable individuals is actually not large enough to block violations. When criminal offences are committed, detected, and tried, offenders found guilty are subject to punishments by criminal courts.

Provisional Measures on Prohibition of Securities Fraud. The Provisional Measures on Prohibition of Securities Fraud were introduced by the State Council Securities Committed on 2 September 1993 to deal with insider trading, market manipulation, false disclosure of information, and other forms of securities fraud.

Provisional Regulations on Share Issuing and Trading. The State Council promulgated the Provisional Regulations on Share Issuing and Trading on 22 April 1993. It is clarified that the director's duty of information disclosure is one aspect of directors' fiduciary duties to the company.[140]

The regulations identify three types of false statement (ie, false recording, misleading statement, and material omission) but failed to provide detailed definitions of these false statements. Article 77 is the only provision dealing with the issue of civil liability and compensation and states that 'where the provision of this regulation is violated and losses are caused to others, it shall bear liabilities for civil compensation according to law'. Those who commit insider trading are subject to a fine between RMB 50,000 to 500,000 in addition to confiscation of illegal gains.[141]

Special Provisions on Share Issuing and Listing outside China by Listed Companies. The State Council issued the Special Provisions on Share Issuing

138 Criminal Law 1999, art 160.
139 Criminal Law 1999, art 181.
140 Special Provisions on Share Issuing and Listing outside China by Listed Companies, art 23.
141 Special Provisions on Share Issuing and Listing outside China by Listed Companies, art 72.

and Listing outside China by Listed Company in August 1994. The purpose of this piece of regulations is to standardize the issuing of H-shares and N-shares. Along with the regulations, there was a set of the Compulsory Provisions in the Articles of Association of Companies Seeking Listing outside China in August 1994.

Accounting Standards — Disclosure. The Ministry of Finance is indirectly involved in the building up of the disclosure regime by setting accounting standards.

It first released the Accounting Standards of Joint-Stock Companies as early as in 1992, adopted the Accounting Standards — Disclosure in 1997, and announced the System of Enterprise Accounting Rules and the System of Enterprise Auditing Rules.

Rules Concerning Disclosure by Listing Companies. The CSRC assumes its day-to-day duty to administer and supervise the development and operation of the securities market in China. The CSRC released several rules governing information disclosure before the Company Law was enacted in 1993. For instance, the first piece of rules was the Implementing Rules on Information Disclosure by Listed Companies (for trial). The minimum required disclosure documents include the prospectus, the listing announcement, the annual and semi-annual reports, as well as the interim report.[142]

The duty to disclose is clearly imposed on the directors who are required not to disclose false or misleading statements or make gross omission in the disclosed documents.[143] The directors and promoters are jointly liable for misconduct or violation. Some detailed requirements appeared for the first time as part of the disclosure rule. For example, in the takeover announcement, personal details and shareholding of directors must be disclosed.[144]

Regulations on the Issue of Foreign Shares by Listed Companies in China. The State Council in December 2005 issued the Regulations on the Issue of Foreign Shares by Listed Companies in China to standardize the issuance of B-shares. Listed companies seeking B-share issuance must disclose information to the public.[145]

However, it is not clear who is liable for violation though it can be argued widely that directors, supervisors, and senior managers may be liable as the duty to disclose may be part of the fiduciary duty owed by the directors, supervisors, and senior managers to the company.

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142 Implementing Rules on Information Disclosure by Listed Companies (for trial), art 4.

143 Implementing Rules on Information Disclosure by Listed Companies (for trial), art 5.

144 Implementing Rules on Information Disclosure by Listed Companies (for trial), item 2 of art 22.

145 Regulations on the Issue of Foreign Shares by Listed Companies in China, art 16.

Rules on Content and Format of Information Disclosure by Listed Companies. The CSRC issued in total 24 sets of Rules on Content and Format of Information Disclosure by Listed Companies from 1993 to mid-2009.

The rules cover main issues surrounding information disclosure, including initial public offering prospectus, annual reports, semi-annual reports, reports of changes in shareholding, share listing announcements, and prospectuses of issuing new shares. These rules are the core of the disclosure regime.

Making and Reporting Rules Concerning Disclosure by Listed Companies. The rules were issued by the CSRC in 2000 for the purpose of standardizing disclosure in the implementation of the Content and Format Rules in specific industries, such as real estate property, energy, and finance. These rules are detailed enough to cover specific industries, takeover, and acquisition activities.

Other CSRC Rules, Directives, and Opinions Concerning Disclosure. The CSRC from time to time issued circulars or measures to regulate the disclosure regime. For example, it issued the Circular Number Concerning Engagement of Accounting Institutions by Companies to Issue Shares, which requires the issuing companies to provide profit-making forecasting materials.

The CSRC also released the Questions and Answers Concerning Disclosure Standards by Listed Companies in April 2001. The nature of such documents is directives on particular questions raised by the listed companies. Although these documents are not necessarily legally binding, they are still important in guiding the listed companies in their business conducts. In order to enforce compliance, the CSRC also published its administrative decisions on the cases in breach of disclosure rules in 2001. These decisions increased transparency of law enforcement and interpretation.

Listing Rules and Business Rules of the Stock Exchanges. Listing Rules and Business Rules of both the Shanghai Stock Exchange and Shenzhen Stock Exchange contain disclosure provisions.

The first batch of listing rules of these two local stock exchanges was made by the local governments and was approved by the People's Bank of China. Now the listing rules mirror the disclosure requirements in the Securities Law.

Disclosure in IPOs

In General. There are two ways to set up a joint-stock company: either by means of sponsorship or a share offer.[146] While the former means to incorporate a company by subscription from the sponsors of all the shares to be issued by the company, the latter means to incorporate a company through the sponsor's subscription of a portion of the shares with the rest to be offered to the public by

146 Company Law 1993, art 74.

a public offer.[147] As far as an SOE is concerned, the transformation of an SOE to a joint-stock company must be conducted by means of a public offering.[148]

There were three forms of share issuing: a public offer, pre-decided share issuing, and an internal offer. In a public offer, the general public had the equal rights to decide whether to accept the offer, and if so, they get public shares and would be able to transfer these shares freely. In a pre-decided offer, the shares were offered to particular entities or government departments, which get legal entity shares or state-owned shares. These shares were not freely transferrable until late 1999. An internal offer was made to employees at a discounted price. Shares obtained in this way were called internal employee shares.

Issuing shares must meet the information disclosure requirement. For instance, a company issuing B-shares is required to have detailed clauses concerning information disclosure in the articles of association, including the place of disclosure and the means of disclosure.[149] The disclosure must satisfy the requirement of accuracy, truthfulness, and completeness.[150]

Continuous Disclosure. Continuous disclosure is dealt with by the Securities Law 2005.[151] Continuous disclosure also is required by the Code of Corporate Governance in Listed Companies,[152] which requires the listed companies to timely disclosure all the information with a material impact on the decision-making of shareholders and other stock holders in listed companies.[153] Corporate governance also is part of the content of information disclosure.[154] The information must include (i) the directors and supervisors of the company; (ii) the work of the board of directors and the supervisory board and the evaluation on their work; (iii) the work of independent directors and their evaluation; (iv) the structure of the committees of the company and their work; and (v) the plan and measures for improving corporate governance.[155] Companies with shares or bonds listed on Chinese securities exchanges are required to publicly announce and submit a report to the CSRC and the relevant securities exchange in the following circumstances:

- Submission of an interim report containing the following details within two months of the first six months of the financial year of the company: (a) the financial and accounting report and the operations of the company, (b) major litigation involving the company, (c) changes regarding the issued shares and

147 Company Law 1993, art 74.
148 Company Law 1993, art 75.
149 State Council's Provisions Concerning Listing of Foreign-invested Shares by Joint-Stock Companies Inside China 1995, art 2.
150 Implementing Rules on Foreign Invested Share Issue by Joint-Stock Companies Inside China 1996, art 12.
151 Securities Law 2005, arts 63–72.
152 Code of Corporate Governance in Listed Companies, chapter 7.
153 Code of Corporate Governance in Listed Companies, art 88.
154 Code of Corporate Governance in Listed Companies, art 91.
155 Code of Corporate Governance in Listed Companies, art 91.

bonds of the company, (d) other important matters submitted for shareholders' approval, and (e) other matters prescribed by the CSRC; and

- Submission of a final report containing the following details within four months after the end of the financial year of the company: (a) the business conditions of the company, (b) the financial and accounting report and operations of the company, (c) details relating to shareholdings in the company of its directors, supervisors, and management personnel, (d) details relating to the issued shares and bonds of the company and the shareholdings of its 10 major shareholders, and (e) other details required by the CSRC.

Submission of an extraordinary report upon the occurrence of material events which may have a significant impact on the price of its shares and which are not yet known to its shareholders should be made on the following occasions:

- Significant changes to the business policy and business scope of the company;
- Decisions on major investment or asset acquisition by the company;
- Entry into contracts which may have a material impact on the assets, debts, rights, and operation results of the company;
- Incurring of material debts by the company and failure to repay material debts on time;
- Incurring of serious losses or losses which exceed 10 per cent of net assets of the company;
- Significant changes to the external business conditions of the company;
- Changes in the chairman of the board, or in over one-third of the directors or management personnel of the company;
- Significant changes to the shareholdings of shareholders which hold more than five per cent of the shares in the company;
- Reduction in registered capital, merger, division, dissolution, and application for bankruptcy of the company;
- Material litigation involving the company and the setting aside of board or shareholders' resolutions of the company by the court;
- Where the company is involved in any crime, which has been filed as a case as well as investigated into by the judicial organ or where any director, supervisor or senior manager of the company is subject to compulsory measures as rendered by the judicial organ; or
- Other matters as prescribed by law or administrative regulations.

The requirement of continuous disclosure is materialized in the requirement of documents, such as the annual report,[156] half-yearly report, quarterly report, and interim report. The annual report must include the report of the chairman of the board of directors or the general manager.[157] The chairperson must in his report

156 Securities Law 2005, art 136.
157 Securities Law 2005, art 68.

address such matters as the achievements, financial statements, investment activities of the company and its subsidiaries or holding companies, a statement of employees, a statement regarding the problem in the operation of the company and the resolutions to these problems, and other related issues.

The annual report also needs to include a report of the board of directors.[158] This report should include information such as the company's shareholding and shareholders (at the beginning and end of each year) and any changes to the shareholding or shareholders; directors (ie, biographical details and remuneration information), supervisors, and senior managerial staff; and lawsuits and arbitration cases the company is involved in.

The requirement to release the semi-annual report first appears in the Company Law 1993 and reappears in the Company Law 2005.[159] The main items included in the semi-annual report are listed in the 1993 Interim Regulations.[160] The CSRC Rule Number 3 on Content and Format of Information Disclosure by Listed Companies, regulating the content of the semi-annual report, was issued in 1994 and was further amended in June 1996 and June 2000.

Listed companies also are required to make disclosures in the interim reports for any event that may affect the trading price of shares. In terms of the timing, the Securities Law 2005 provides that a listed company immediately disclose any major event that may have a material impact on the share price immediately after it takes place.[161]

No definition or interpretation has been provided to the term 'immediately' in this provision, which, in practice, leaves a loophole for a company to delay the disclosure process.

Content of Disclosure. The disclosure regime in China only requires the issuer to disclose such information that may have a material effect on the share price. Such information may include:

- Major contracts entered into by the company which may have substantial effect on the company assets, debts, interest, and/or operation;
- Major changes to the operation policy or projects of the company;
- Major investment or purchase of expansive long-term assets;
- Major debts;
- Breach of contract, ie, failure to pay outstanding debts;
- Major losses;
- Major damage to the assets;
- Major changes to the operational environment;

158 Securities Law 2005, art 68.
159 Company Law 2005, art 156.
160 Interim Regulations 1993, art 58.
161 Securities Law 2005, art 67.

- Newly released laws, regulations, and rules, which may have a material effect on the business operation;
- Change to the chairman of the board, 30 per cent of the board members, or the general manager;
- Increase or decrease of one class of shares held by a shareholder holding more than five per cent of the shares;
- Major lawsuits involving the company; and
- Liquidation or insolvency of the company.[162]

Other disclosure requirements are scattered in other laws, regulations, and rules. Rule Number 1 requires listed companies to disclose risks, related-party transactions, and the corporate governance structure of the companies.

Related-Party Transactions. Related-party transactions also are termed as affiliated transactions or connected transactions, which refer to transactions between a company and its related companies or persons. A related party refers to a related legal person or a natural person. Related-party transactions are discouraged or prohibited in order to avoid an improper diversion of the company's profits to its affiliates.

In takeovers, disclosure obligations are imposed on defined persons including holders of shares, persons in control of shares, and persons acting in concert.[163] The person who is under the legal obligation to make disclosures should follow the timeline, content, and form of disclosure so as to avoid insider trading during the process of changing the shareholding of the company.[164] A covered person needs to submit a report of shareholding change to the CSRC and the stock exchange. Meanwhile, the covered person should notify the issuer and make a public announcement when submitting the report.[165]

If approval is required from the competent authorities, the related parties should not make a public announcement until three days after such approval had been obtained.[166] A covered person is required to file the report when his shareholding reached the five per cent threshold, or for an existing five per cent holder, when his holding varies by five per cent of the company's total shares. The covered person is prohibited from participating in the share issuing

162 State Council's Interim Regulations on Administration of Shares Issuing and Trading 1993, art 60.

163 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, art 6.

164 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, art 4.

165 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, art 12.

166 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, art 28.

transactions in the fixed periods.[167] Where the covered person's shareholding varied by one per cent by virtue of the transactions on the stock exchange, the public announcement should be made in relation to such a transaction.[168] An acquisition report needs to be submitted to the CSRC if the transaction results in a controlling stake of 30 per cent or more shareholding in the company.[169]

Under the Takeover Procedures 2006, investors taking control of five per cent of a listed company are required to make a public announcement. An investor holding a stake of more than 20 per cent is required to make a detailed disclosure of its financial status.[170] A shareholder who intends to purchase more than five per cent of shareholding must indicate its intention whether he plans to acquire more shares.[171] The disclosure regime is further strengthened under the Takeover Procedures 2006, which requires the disclosure of information, by ultimate owners of multiple listed companies.[172] Financial advisers are subject to a mandatory one-year duty to ensure the accuracy of information disseminated by the company within one year after the transaction.[173]

Remedies

In General. Civil, administrative, or criminal remedies may be available to the investors who suffer losses from any breach of disclosure duties. Under the Securities Law, any violation may result in civil compensation liability.[174] However, the Securities Law is silent on how to apply this general principle. Without legislative guidance, the courts indicate their reluctance to accept and rule on the civil compensation claims.[175] The Supreme Court released a judicial interpretation on 15 January 2002 entitled the Circular Number on Relevant Issues of Filing of Civil Tort Dispute Cases Arising from False statement on the Securities Market.[176] On the same date, the intermediate people's courts designated by the Supreme Court commenced to accept and hear civil compensation cases arising from false statements on China's stock markets. Nevertheless, the Circular Number is not practically useful as it set a

167 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, arts 15–18.
168 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, art 30.
169 The Administration of Disclosure of Information on the Change of Shareholdings in Listed Companies Procedures, art 20.
170 Takeover Procedures 2006, art 17.
171 Takeover Procedures 2006, art 16.
172 Takeover Procedures 2006, art 12.
173 Takeover Procedures 2006, art 65.
174 Securities Law 1998, art 207.
175 The Notice of the Supreme People's Court on Temporary Refusal of Filings of Securities-related Civil Compensation Cases (issued by the Supreme People's Court on 21 September 2001).
176 On its face, it is clear that this Circular Number does not cover those cases arising from insider trading or market manipulation.

prerequisite that the alleged false disclosure be investigated and handled by the CSRC first.

This prerequisite condition raised criticism in general public. The Supreme Court on 9 January 2003 released the Several Provisions on Hearing Civil Compensation Cases Arising From False Statement on the Securities Market ('False Statement Provisions'), which changed the prerequisite of the 2002 Circular Number so that the alleged false disclosure conduct must have been dealt with by the CSRC or have been tried by a criminal court. Together with the Civil Procedure Law and other relevant regulations and rules, intermediate people's courts finally have the guidance necessary to deal with compensation claims arising from securities-related false statements. The Securities Law 2005 reassured the civil compensation principle but left details untouched. The lack of detailed legislative and judicial guidance means civil remedies cannot be used as a tool for the protection of shareholders.

False statement, is defined in the False Statement Provisions as a false recording, misleading statement, material omission, or improper disclosure, all of which are made against the true fact of major events by those who have a duty to disclose information on the securities market.[177] Four types of false statements are covered by the False statement Provisions: (i) a false recording occurs when those who have a duty to disclose information present non-existing facts in disclosure documents; (ii) the misleading information is made by two wrongdoers in disclosure documents or announcement to the media which influences investors to act, resulting in significant detriment to their investments; (iii) a material omission is the failure to disclose, either wholly or partially, required information by one with the duty to have done so; (iv) improper disclosure occurs when one has a duty to disclose information, but fails to do so within an appropriate time frame or in the appropriate manner prescribed by law.[178]

The False Statement Provisions also indicate that false statements are related to material events.[179] The Supreme People's Court's False Statement Provisions filled in the gaps left by the Securities Law, which merely identified the first three types of false statement but failed to provide detailed definitions. Those who make false statements directly or indirectly may be liable to investors in a civil suit. The False Statement Provisions list a wide range of companies, organizations, and individuals, including (i) promoters, controlling shareholders, and the like who exercise actual control; (ii) issuers or listed companies; (iii) securities underwriters; (iv) securities listing sponsors; (v) professional intermediaries, including accounting firms, law firms, and valuation firms; (vi)

177 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 17.

178 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 17.

179 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 17.

responsible directors, supervisors, managers, and other senior management personnel of the issuers, listed companies, securities underwriters, or securities listing sponsors; (vii) directly responsible persons of professional intermediaries; and (viii) other organizations or individual persons who make false statements.[180]

This list is broad enough to cover companies or organizations involving foreign parties such as joint ventures, as well as promoters, controlling shareholders, and those who exercise actual control over the company. It is worth noting that this list is not an exhausted list and 'other organizations and individual persons who make false statements' also may be held liable.[181] This open-ended provision leaves more leeway to the courts, and sends a warning signal to those who are involved in the securities activities and participate in the disclosure of information. These individuals and companies may be sued by the investors as individual or joint defendants.[182]

The pre-condition for an investor to bring a claim to a court or for a court's exercise of its jurisdiction over the compensation claim is the existence of an effective administrative penalty decision or a criminal court judgment made against the wrongdoer for their false statements,[183] unless the CSRC or its regional office has already investigated the alleged false statement and imposed an administrative penalty on which investors could rely upon as a factual basis of their actions.[184] This prerequisite is relaxed only if the criminal judgments by the courts and administrative penalty decisions made by the authorities other than the CSRC or its regional offices are made.[185] This restrictive prerequisite, without a legislative or judicial basis, not only deprives the investors of the civil litigation right,[186] but also offers the makers of false statements more opportunities to escape their liabilities by using their social connections or bribery to influence relevant authorities not to take administrative actions.

Although the prerequisite procedure may save judicial resources and help investors collect evidence and reduce their burden of proof, the defect is apparent in that the investors may be unable to obtain remedies if an alleged

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180 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 7.

181 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 7(7).

182 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 12.

183 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 6.

184 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 2.

185 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 2.

186 Guiping Lu, 'Private Enforcement of Securities Fraud Law in China: A Critique of the Supreme People's Court 2003 Provisions Concerning Private Securities Litigation', (2003) *Pacific Rim Law and Policy Journal*, 781, 795-98.

false statement is not punished by administrative regulator or criminal court. In reality, the court may review a series of issues to determine its jurisdiction. These issues include the statute of limitation period, form of action, possibility of mediating the dispute, and losses suffered by the investor as a result of false statements. [187]

The form of action available to investors is limited to individual action or joint action.[188] The joint action resembles the class action under US law in some respects. Nevertheless, the differences between the two also are obvious in respect of the registration requirement, plaintiff's rights, representative's powers, and binding effect of the court rulings.[189] This suggests that class action is not an acceptable form of action for civil compensation cases arising from securities-related false statements even though the United States-style class action is more economic for this type of litigation.[190]

The Chinese characteristic with the securities-related civil litigation is that parties are encouraged to use mediation in the civil litigation process. [191] Mediation also may help reduce litigation costs and caseload. If mediation is conducted in conjunction with litigation, some civil procedures need to be followed. For instance, mediation must be conducted on a voluntary basis.[192] Mediation can be conducted by the court before trial or at any stage prior to judgement.[193] A mediated agreement comes into effect once it has been duly delivered to and signed by the parties.[194]

This means that any party may change his mind before the mediated agreement is signed and accepted. Even after the signing of the mediated agreement, the parties may still challenge the legal effect by arguing that the mediation violates the principle of voluntariness. As a result, the case may have to be retried.

How to determine the defendant's liability? Different rules apply: some defendants such as promoters, issuers, listed companies, and controlling shareholders or those who have actual control over issuers or listed companies are subject to strict liability while others, including underwriters, sponsors, intermediaries (accounting firms, law firms, and asset valuers), directors,

187 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 6.

188 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 12.

189 Walter Hutchens, 'Private Securities Litigation in China: Material Disclosure about China's Legal System?' (2003) *University of Pennsylvania Journal of International Economic Law,* Vol. 24, p. 641.

190 Susan V. Lawrence, '*Shareholder Lawsuits: Ally of the People' Far Eastern Economic Review*, 9 May 2002, at 27.

191 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 4.

192 Civil Procedure Law, art 85.

193 Civil Procedure Law, art 128.

194 Civil Procedure Law, art 89.

supervisors, managers of issuers, listed companies, underwriters, and sponsors, are subject to a fault-based liability.[195]

Investors must establish a causal link between false statements and losses.[196] To establish a causal link, the court must find that (i) the investments are securities directly connected with the false statement; (ii) the purchase date of the securities is between the date on which the false statement is made and the date on which the false statement is exposed or corrected; and (iii) that the investor suffers losses as a result of selling securities on or after the date on which the false statement is exposed or corrected, or as a result of continued ownership of the securities after the false statement is exposed or corrected.[197]

Not all the investors are able to claim losses. Only those investors who purchase securities after a false statement is made but before the false statement is exposed or corrected, and then sell the securities or continue to hold them after the false statement is exposed or corrected, are entitled to claim compensation for the losses they suffered. The investor may not be able to obtain compensation if the defendant is able to prove (i) the plaintiff purchases or sells the securities outside the period prescribed by the rules; or (ii) his loss was caused by other risk factors of the market; or (iii) he had knowledge of the false statement but made an investment anyway; or (iv) he made in the investment in bad faith with the aim of manipulating the market. Investor compensation for losses is limited to the amount of actual loss.[198] The actual loss has three aspects: (i) the difference of their investment; (ii) the commission, charge, and stamp duty in connection with the lost investment; and (iii) the interest lost for their investment as calculated according to the bank deposit rate for the relevant period.[199]

The CSRC has broad administrative powers to enforce securities laws and regulations, and may exercise its powers to supervise the securities market by imposing administrative liabilities on companies and management involved in misconduct or violations:

- Stop order: the CSRC has the power to order the company to stop issuing shares and to refund money to the subscribers of shares.[200] The CSRC may stop underwriters (without licenses) from trading in securities as brokers.[201]

195 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, arts 21–25.

196 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 18.

197 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 18(1)–(3).

198 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 30.

199 Several Provisions on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market, art 30.

200 Securities Law 2005, art 179.

- Confiscation: Profits generated from misconducts or illegal activities may be confiscated by the CSRC.[202]
- Order to correct false or misleading information and misstatements: the listed companies or its directors, officers, or supervisors may be ordered by the CSRC to correct false or misleading information and misstatements.[203]
- Administrative fine: the CSRC may impose administrative fine between RMB 30,000 and 300,000 on company officers, directors, or supervisors who are directly involved in obtaining approval for share issuance via false information.[204] Persons who forge and pass on false information will be fined between RMB 30,000 and 300,000.[205] Lawyers, accountants, or assets valuers giving false information or reports will be fined between RMB 30,000 to 100,000.[206]
- Warnings: the CSRC has power to issue warnings to company officers who are involved in obtaining approval for share issuance by giving false information, or giving false or misleading information or misstatements.[207]
- Disqualification: the CSRC has power to disqualify professional staff of stock exchanges, securities companies, securities registration, and settlement companies if they are involved in the disclosure of false or misleading information and misstatements.[208] The CSRC also may disqualify other professionals such as lawyers, accountants, or assets valuers together with competent authorities, such as the Ministry of Justice, Ministry of Finance or State Administration of State-owned Assets Commission. The CSRC also may disqualify securities companies from securities businesses for their being involved in giving false documents or fraudulent activities.[209]

Although the CSRC may exercise its administration power and impose various administrative liabilities, these will not directly benefit the party who suffers losses from false or misleading information. Even confiscated assets or administrative fines will be regarded as the state's revenue. Given the amount of illegal profits generated from the illegal market activities, the amount of administrative fine may be no longer effective as a regulatory tool.

The last resort available to the CSRC may be criminal remedies available under the amended Criminal Law, including criminal fines,[210] detention[211] and

201 Securities Law 2005, art 179.
202 Securities Law 2005, art 179.
203 Securities Law 2005, art 179.
204 Securities Law 2005, art 189.
205 Securities Law 2005, art 191.
206 Securities Law 2005, art 200.
207 Securities Law 2005, art 179.
208 Securities Law 2005, art 233.
209 Securities Law 2005, art 222.
210 Criminal Law, art 158.
211 Criminal Law, art 159.

imprisonment,[212] which may be imposed separately or jointly. The range of criminal fines is one per cent to five per cent of false registered capital if a company manages to be registered with false documents.[213] The range of criminal fines is from two per cent to 10 per cent of the falsified registered capital if the company manages to be registered with false documents.[214] One per cent to five per cent of the illegally raised capital is subject to the criminal fine if the prospectus or other company documents contain any false information.[215] The directly responsible officers of the company will be fined RMB 20,000 to 200,000.[216] The amount of criminal fine is not large enough to discourage any violation. The term of imprisonment for misconduct or violation of securities regulations and laws is not long either, with the maximum term of five years.[217]

Inspection of Listed Companies. The CSRC is granted the power to inspect companies listed on the Shanghai and Shenzhen Stock Exchanges but not overseas companies or companies whose stocks are traded on other stock exchanges. Chinese law authorizes the CSRC to assign this power to a body conducting inspections and employing registered and qualified accountants and lawyers when necessary to complete the task.

There are two types of inspections, routine and special. Routine inspections are conducted to assess the veracity of information, the integrity of management structures, the integrity of accounting procedures, company autonomy, and the conformity of actual capital expenditure to that proposed in the company prospectus. By contrast, special inspections are conducted to verify whether a problem exists within a company, and deal primarily with matters related to capital usage, stockholder complaints, and material asset restructuring.

The inspection is conducted on the basis of documents such as accounting reports, minutes of stockholder meetings and company staff, and explanations of company structures. The company will be informed by the inspecting body of any problems discovered, and a copy of the notification will be sent to the stock exchanges on which the company is listed. The company can appeal within 10 days of the notification to the CSRC. In any event, the company shall report any measures it has taken to the inspecting body within a month of receiving the notification. The CSRC has the right to publish a public or non-public criticism according to the gravity of the alleged breach. Companies under investigation are prohibited from co-ordinating with the accounting firm conducting an audit. Failure of an inspection to reveal illegal acts committed by company officers does not absolve the respective individuals of legal liability for those acts.

212 Criminal Law, art 159.
213 Criminal Law, art 158.
214 Criminal Law, art 159.
215 Criminal Law, art 160.
216 Criminal Law, art 161.
217 Criminal Law, arts 158, 159, 160, and 181.

Gatekeepers. The ministries and commissions of the central government jointly or separately enact and implement laws, regulations, and rules to punish and prevent misleading, deceptive, and fraudulent conduct in the process of listing. Due to the lack of coordination and co-operation, the rules governing the gatekeepers and their market conducts are in conflict, which furthers inefficiency and malpractice in the securities market.

Acquisition of Listed Company

In General

Legal Framework

The legal framework prior to 2002 provided for forms and procedures for the acquisition of state-owned assets or stocks, and attached great importance to valuation of state-owned assets. The new regime lifted the ban on foreign investor involvement in the acquisition of state-owned stock. Acquisitions of listed companies in China are now subject to an array of regulations governing various issues relating to the acquisitions of domestic enterprises by foreign investors, such as application documents, approval procedures and timeframes, valuation of stock or assets to be acquired, capital increase of the target after merger and acquisition, and an antitrust regime. The main regulations are the Administrative Regulations on Acquisitions of Listed Companies and the Administrative Regulations on Information Disclosure for Shareholding Changes of Listed Companies, both effective on 1 December 2002 and both milestones in the development of the Chinese securities market, providing the first comprehensive regulation of the acquisition of listed companies in China.

These regulations were further superseded by the 2006 Amendment of the Measures for the Administration of the Acquisition of the Listed Companies in July 2006, the major objective of which is to increase disclosure and transparency (the promulgation of the Acquisition Regulation and the Disclosure Regulations has helped establish a relatively comprehensive system of information disclosure requirements), which is in line with the legal environment for mergers and acquisitions in post-WTO accession of China.

So long as the general corporate laws on foreign investment and applicable securities regulations are satisfied, foreign investors are allowed to acquire equity interests in Chinese companies, either domestic or foreign-invested according to the Provisions on Acquisition of Domestic Enterprises by Foreign Investors effective as of 8 September 2006. Acquisition of equity interests in FIEs must follow the regulations and rules governing FIE equity change, except that listed shares of FIEs are regulated in the same manner as other listed companies. Under the current legal framework, the acquirer can purchase a listed company by agreement, offer, or centralized competitive pricing at the securities exchanges, subject to relevant disclosure requirements.

Acquisition by Agreement

A purchaser may acquire a listed company from its shareholders by agreement for shareholding of up to 30 per cent. Once an acquisition agreement is made, the purchaser must file a listed company acquisition prospectus with the CSRC and the relevant securities exchanges within three days and make a public announcement.

The target also needs to publicize the opinion of the board, independent directors, and third-party advisers confirming that the acquisition is in the best interests of the company. The acquisition agreement may not be implemented before the public announcement. Parties to an acquisition agreement may appoint a securities registration and settlement institution to retain custody of the shares to be transferred under the agreement and deposit the required funds in a designated bank.

Acquisition by Offer

Once a shareholder holds 30 per cent of the issued shares of a listed company and intends to continue acquiring shares in the company, it can make an offer to all the other shareholders of the company. In this situation the proportion of the shares proposed for such acquisition may be no less than five per cent of the shares issued by the company.

A shareholder making an offer is required to submit an acquisition offer report to the CSRC and the relevant stock exchange. The report must contain particulars relating to the purpose, duration, price, number of shares, and total sum involved in the acquisition. The shareholder must then publicly announce the acquisition offer within 15 days of submission of the report.

The offer period may not be shorter than 30 days or longer than 60 days. During the offer period, the shareholder may not withdraw its offer or acquire shares in the company by any other method or on terms different from those of the offer. Any amendments to the offer require approval from the CSRC and the relevant securities exchange.

The shares of the listed company must be terminated from the stock exchange if the distribution of the equities amongst the shareholders fails to meet the listing condition after the expiration of the term of the takeover. However, before the completion of the takeover, holders of the remaining shares shall be entitled to require the shareholder to purchase their shares on the same terms as the offer, and the purchaser shall purchase such shares.

Acquisition of Shares through the Stock Exchange

For securities transactions made through the stock exchange, an acquirer may notify the CSRC, the relevant securities exchange, and the relevant company and make a public announcement within three days after its shareholders in a

listed company reaches five per cent. The acquirer may not take any further action such as any dealings of the shares within the three-day period.

The reporting and announcement requirements apply in the relevant that the shareholder increases or decreases its shareholding in the company by five per cent. The acquirer may not have any further dealing in the shares in the listed company during the three-day reporting period nor the two-day period after the notification and public announcement. Currently, foreign acquirers are subject to restrictions on direct acquisition of shares through the Chinese stock exchanges.

Qualified Foreign Institutional Investor

The joint promulgation of the Administration of Securities Investments in China by Qualified Foreign Institutional Investors Tentative Procedures (the 'QFII Tentative Procedures') by the CSRC and PBOC on 5 November 2002 marked a substantial step in opening the securities markets to foreign investors and represented the dropping of yet another barrier to the full integration of the PRC securities market with international securities markets.

In order to implement the QFII regime, the Shanghai Stock Exchange and Shenzhen Stock Exchange issued the Shanghai Stock Exchange Qualifying Foreign Institutional Investors Investing in Domestic Securities Markets Securities Trading Implementing Regulations and the Shenzhen Stock Exchange Qualifying Foreign Institutional Investors Investing in Domestic Securities Markets Securities Trading Implementing Regulations, respectively (collectively, the 'QFII Implementing Regulations' promulgated on and effective from 1 December 2002). These regulations provide new investment choices, structures, and opportunities for foreign investors in China.

On 24 August 2006, the CSRC, PBOC, and SAFE jointly issued the new Measures for the Administration of Securities Investments in China by Qualified Foreign Institutional Investors, effective from 1 September 2006 (the 'New QFII Rules') to supersede the original QFII rules that have been in place since 2002 and to govern the QFII regime. The CSRC also issued a notice relating to the implementation of the New QFII Rules (the 'Implementing Notice') that took effect from the same date.

The QFII Tentative Procedures open the A-share and domestic bond markets to foreign investment for the first time as long as the investors meet the relevant criteria as QFII. QFIIs can invest within their approved investment limits in any of the following RMB-denominated financial instruments:

- Shares listed on the domestic stock exchanges (except for foreign investment, or B-shares, listed on a domestic exchange);
- Treasury bonds listed on the domestic stock exchange;
- Convertible bonds and corporate bonds listed on the domestic stock exchange; and
- Any other financial instruments approved by the CSRC.

The Implementing Regulations stipulate that QFIIs cannot participate in treasury bonds repurchase and corporate bonds trading because of 'technical reasons', which is unfortunate for prospective QFIIs as, given very high P/E ratios on which most A-shares are currently trading, treasury and corporate bonds markets were viewed as one of the more attractive parts of the QFII regime.

There is no substantial change in the permitted investments under the New QFII Rules except that it is now expressly stated that investments may be made in securities investment funds and warrants. The New QFII Rules also stress that the applications from qualifying institutional investors that are pension funds, insurance funds, mutual funds, charitable funds, and other long-term asset management institutions will be given priority with a view to encouraging mid- to long-term investments in China.

According to the QFII Tentative Procedures, a QFII must be a fund management institution, an insurance company, a securities company, or another type of asset management institution. The CSRC and PBOC require the securities houses and insurance companies to have been operating for 30 years or more, while there is no track record requirement for commercial banks. The QFII applicant must satisfy various criteria:

- An applicant must be financially stable, enjoy good credit, satisfy the asset size test and other CSRC requirements, such as a certain amount of paid-up capital and a certain level of assets under management;
- An applicant's risk control and monitoring standards must meet the legal requirement and the relevant securities markets regulators' requirements in its country or region of establishment;
- An applicant's professional staff who engage in the business must hold the relevant professional qualifications in the relevant country or region. The applicant must have a sound corporate governance structure and a comprehensive set of internal controls, its operations must be carried out in accordance with applicable law, and in the last three years it may not have been subject to any material sanctions by any regulator in the relevant country or region where it is established; and
- There must be a comprehensive legal and supervisory system in place in the applicant's country or region of establishment, its securities supervision and management institutions must have entered into a memorandum of understanding on co-operation in matters of supervision and management with the CSRC, and it must have maintained an effective regulatory co-operation relationship with the CSRC.

Under the New QFII Rules, the qualifying criterion in terms of assets-under-management (AUM) for QFII applicants that are fund management institutions, has been reduced from US $10 billion to US $5 billion in the most recent financial years, although the requirement to have operated fund management business for more than five years remains. This will enable more fund

management companies to apply on their own for QFII approval and QFII quota instead of relying on third-party QFII quotas for their China-focused funds or investing indirectly through structured products.

Furthermore, the qualifying criterion for insurance companies is changed from at least US $10 billion in AUM to at least US $5 billion in securities assets held in the most recent financial year. There is no change to the qualifying criteria for securities companies and commercial banks. In the Implementing Notice, other financial investors such as pension funds, charitable funds, donation funds, trust companies, and government investment companies are subject to the qualifying criterion of having been established for at least five years and having AUM or having a securities portfolio with at least US $5 billion in the most recent financial year.

An applicant must, through the custodian, first submit a standard application form and a specified list of documents to the CSRC and SAFE, respectively, in order to gain approval as a QFII. The CSRC will examine the application materials, seek the opinion of SAFE, and render its decision on whether or not to grant its approval within 20 working days from the date of receipt of the complete set of application documents. If the CSRC decides to grant approval, it will issue a securities investment business permit. Within one year from the date of receipt of the securities investment business permit, the applicant shall apply through the custodian to SAFE for an investment quota. SAFE will examine the application materials, seek the opinion of the CSRC, and render its decision on whether or not to grant its approval within 20 days from the date of receipt of the complete set of application documents.

If SAFE decides to grant approval, it will render a written official reply and issue a foreign exchange registration certificate. Under the SAFE's Administration of Foreign Exchange for Securities Investments in the PRC by QFIIs Tentative Provisions of 2002, QFII applicants are required to apply for an investment limit not lower than US $50 million and not exceeding US $800 million. Until SAFE issues a corresponding set of rules detailing the foreign exchange requirements to accompany the issuance of the New QFII Rules, the previous set of SAFE rules still apply.

According to the QFII Tentative Procedures, once the QFII has obtained the SAFE approval for its investment limit, it can open a special purpose RMB account with its custodian. The account is used to hold the conversion proceeds in RMB of the original foreign exchange funds paid in by the QFII and is used to fund purchases and other related costs as well as holding proceeds of disposals. QFIIs are required to remit the full amount of principal in the foreign currency approved by SAFE into the PRC for conversion into RMB, and transfer into the RMB special purpose account within three months of the issue of a QFII Permit.

The QFII must also instruct its custodian to open on its behalf a securities account with the securities registration and settlement (ie, clearing) institution (the CSDCCL) and a renminbi settlement account with the CSDCCL for

settlements with that institution. The limitation to opening a single account is potentially problematic because QFIIs mainly act as fund managers and broker dealers managing other people's assets when they invest and the concern is that if the QFII defaults, in the absence of sub-accounts separating proprietary and client assets, the client assets in China may be frozen. This one sub-account rule did not comply with domestic and foreign regulatory requirements and the structural need of QFIIs which are fund management companies in setting up several public funds was not satisfied. Under the New QFII Rules, each QFII is allowed to hold multiple securities sub-accounts with a PRC clearing house that correspond to respective multiple *renminbi* special accounts.

In reality, this is not yet materialized pending SAFE's change in position to allow multiple renminbi special accounts. The securities sub-accounts may be opened as direct accounts or nominee accounts (which are opened for customers to whom the QFII provides asset management service). Where the QFII establishes a securities account for public funds, insurance funds, charitable funds, donation funds, government investment funds, or other long-term investment funds under its management, the account may be opened in the direct name of 'QFII plus fund' and assets in such account belong to the QFII and the custodian. The New QFII Rules require a QFII to file reports to the CSRC and stock exchange within eight working days after the end of each quarter on the underlying investors (such as the name and place of registration) for whom it maintains the nominee accounts and on the investment activities of such investors through such accounts (ie, asset allocation mix and details of the securities investments of the actual investor or fund that it represents).

The New QFII Rules also recognize the interests of underlying investors investing through QFIIs in providing that QFIIs may appoint the actual beneficial investors to exercise shareholder rights with respect to underlying investments, and that as nominee for beneficial investors, a QFII may use its votes in part and may cast its votes in different ways according to the interests of the underlying beneficial investors.

Under the QFII Tentative Procedures, there were lock-in periods for the funds remitted into the PRC by the QFII and held in the renminbi special purpose account. In the case of a closed-end China fund management institution, the QFII can only apply to SAFE for the purchase of foreign exchange to remit to the offshore QFII three years after remitting the principal. For other types of QFIIs, the restriction is one year after remittance of the principal. After the expiration of the lock-ups, each outward remittance cannot exceed 20 per cent of the total principal and each must be made at one-month (for a closed-end China fund QFII) and three-month intervals (for all QFIIs), respectively. A QFII that has remitted its investment principal into the PRC for another three months but less than one year can assign its investment amount to another QFII or another qualifying applicant, subject to the CSRC and SAFE approval.

The New QFII Rules do not set out the specific requirements with respect to remittance and repatriation, but instead provide that remittance, repatriation, and

any lock-up period should be adjusted by SAFE based on the economic and financial situation of the PRC, foreign exchange balance of payments, and according to arrangements set by the PBOC. This means that the previous rules on lock-up periods and repatriation limits in the original QFII rules issued by the CSRC and SAFE are abolished. Hence, at present, there are no rules that impose those lock-up periods and repatriation limits.

Previously, the QFII Tentative Procedures imposed restrictions on the size, in terms of the percentage and monetary terms, of investments made by QFIIs. The monetary limits are set out in the SAFE's Administration of Foreign Exchange for Securities Investments in the PRC by QFIIs Tentative Provisions, issued on 28 November 2002 and effective 1 December 2002, which provide that the minimum investment limit that has to be applied for by a QFII is US $50 million, while the maximum is US $800 million. It is further clarified that the percentage of shares held by a single QFII in a single-listed company cannot exceed 10 per cent of the total A shares in that company and similarly the aggregate percentage of shares held by all QFIIs in a single-listed company may not exceed 20 per cent of the total A-shares in that company. However, these percentages are subject to 'adjustment' by the CSRC. The QFII Tentative Procedures also required that QFIIs disclose their interests in listed companies in accordance with relevant rules and, in this context, to take into account domestic (A-shares or B-shares) and overseas shares (H-shares) of the same company, as well as interests in convertible bonds and depository certificates. The foregoing restrictions are revised as follows under the New QFII Rules:

- Each underlying offshore investor investing through QFII may not hold more than 10 per cent of the total outstanding shares in one listed company (but excluding strategic investment by such offshore investor in accordance with the Regulations on Strategic Investment in Listed Companies by Offshore Investors); and
- All offshore investors may not hold more than 20 per cent of the total outstanding shares in one listed company.

The restriction in the first paragraph, above, looks at the interest of the underlying offshore investor instead of the QFII itself. This would apply to investments held through one QFII or all QFIIs through which the relevant investor invests in the spirit of disclosure of interests in listed companies under relevant rules.

Under the New QFII Rules, a QFII shall appoint a domestic commercial bank to act as the custodian of its assets and appoint a domestic securities company to handle its domestic securities trading activities. Rules about custodian banks' role in the QFII scheme can be found in many regulations, including the Securities Transactions by QFII Implementing Rules (issued on 1 December 2002); and the Registration and Settlement for Securities Investments in China by QFII Implementing Rules (the Settlement Regulations issued on 1 December 2002).

According to the New QFII Rules, a commercial bank in China can apply to the CSRC and the SAFE for permission to undertake a custodian business for domestic securities investments by qualified foreign institutional investors. The New QFII Rules make it clear that those China branches of foreign-invested commercial banks that have continuously operated in China for not less than three years may apply to become custodians. A custodian must meet the following conditions:

- Have a dedicated asset custody department;
- Have paid-up capital of not less than RMB 8 billion;
- Have an adequate number of full-time personnel familiar with custody business;
- Be able to keep safe custody of the assets of the QFII;
- Have the ability to carry out secure, highly efficient clearing and settlement;
- Be qualified as a designated foreign exchange bank and qualified to operate *renminbi* business; and
- Have no record of any major violation of exchange control regulations during the most recent three years.

A custodian must perform the following duties:

- Keep safe all of the assets placed in its custody by the QFII;
- Handle the relevant foreign exchange settlement, sale, receipt, and payment business and renminbi fund settlement business of the QFII;
- Supervise the QFII's investment operations and report to the CSRC and SAFE if the QFII's investment instructions violate laws or regulations in a timely manner;
- Within two working days of remittance of principal into China or remittance of principal or earnings out of China by the QFII, inform SAFE of the particulars of the funds so remitted and the settlement or sale of foreign exchange by the QFII;
- Within eight working days after the end of each month, report to SAFE the details of payments made into and out of, as well as the asset allocation of, the QFII's foreign exchange accounts and special *renminbi* accounts, and to report to the CSRC the details of the investments and transactions of the securities accounts;
- Within three months after the conclusion of each fiscal year, to prepare an annual financial report on the particulars of the QFII's securities investment activities in China during the previous year and to submit the same to the CSRC and SAFE;
- Keep, for a period of not less than 20 years, relevant information such as records of remittances into and out of China, the conversion of funds, the receipt and payment of foreign exchange, and the receipt and payment of funds by the QFII;

- Submit balance of payments statistics in accordance with state foreign exchange control provisions; and
- Perform other duties specified by the CSRC and SAFE in accordance with the principle of prudential regulations.

A custodian is required by the New QFII Rules to keep its own assets and those it manages as custodian strictly apart, and keep separate accounts for those assets it manages as custodian.

Pilot Reform Scheme

The Company Law adopts the principle of equal treatment of shareholders. Theoretically, all shares of common stock of a Chinese corporation enjoy the same rights and privileges. Nevertheless, the share capital of listed companies is segmented depending upon who owns or can lawfully own the shares. For instance, legal person shares are listed and eligible for trading on domestic or overseas stock exchanges, such as A-shares (which are listed on the Shanghai Stock Exchange or Shenzhen Stock Exchange and the trading of which is denominated in renminbi and is restricted to Chinese investors and QFIIs), B-shares (which are listed on either the Shanghai or Shenzhen Stock Exchange but the trading of which is denominated in United States or Hong Kong dollars and is open to both foreign and domestic investors), and H-shares, N-shares, and S-shares. Non-tradable shares are those shares which cannot be traded on stock exchanges and can only be transferred pursuant to private transactions and government approval. Non-tradable shares include state-owned shares held by public authorities or state-owned asset management companies or by SOEs, and legal person shares held by legal persons other than SOEs.

Non-tradable shares once represented around two-thirds of the shares of publicly traded companies and are concentrated in the hands of public authorities. The separate categories of shares, ie, A-shares, B-shares, non-tradable legal person shares, and so on are at the root of the inherent weakness of the markets. They create and maintain artificial disparities in pricing between what should be identical securities and limit the ability of the market to optimize the allocation of capital among business enterprises. In addition, the non-fungibility between different categories of shares translates into price differentials that cannot be justified in the long term. Non-tradable shares are privately sold at big discounts from stock exchange prices.

The PRC government resolved to deal with the segmentation of shareholding structures by implementing the ‘separation of equity ownership and trading rights’. On 29 April 2005, the CSRC issued the Circular Number Concerning

Issues Related to Pilot Reform of Separation of Equity Ownership and Trading Rights of Listed Companies' (the '2005 Circular Number').[218]

The main purpose of such reform is to reduce the public section ownership of listed businesses and restore confidence in the domestic capital markets. The 2005 Circular Number sets the framework to allow a core of pilot companies to covert their non-tradable shares into tradable shares, and further sets out procedural requirements by which the 46 named pilot companies can make their non-tradable shares tradable while protecting the interests of public shareholders and ensuring a gradual release of shares into the market. Each pilot company is required to hold an extraordinary shareholders' meeting to vote on the proposed conversion plan. The plan must be approved by at least two-thirds of the voting rights held by all shareholders attending the meeting, in person or by proxy, and two-thirds of the voting rights held by tradable shareholders attending the meeting, in person or by proxy.

The 2005 Circular Number requires holders of non-tradable shares to agree to lockup restrictions on sales of shares that have been converted pursuant to the trial program. No converted shares can be sold or transferred within 12 months of the conversion date of the shares. A non-tradable shareholder holding five per cent or more of the total outstanding shares will be subject to volume limitations on public sales of shares after the expiration of the lock-up period: no more than five per cent of the company's total outstanding shares can be sold within 12 months, and no more than 10 per cent within 24 months. The lock-up rules are designed to protect the market against an influx of recently converted shares and prevent undue pressure on the pricing of listed stock.

The pilot companies usually need to present a conversion plan offering compensation to existing tradable shareholders to cushion losses they might suffer from a decline in stock prices resulting from dilution. Compensation typically includes a combination of shares, warrants, or put options and sometimes cash. The non-tradable shareholders of the companies are to give up a portion of their equity or make another transfer of value to the tradable shareholders, free of consideration. This requires most companies to transfer shares. Other companies adopt an indirect route. For example, a percentage of the non-tradable shares are to be cancelled so the post-conversion holdings of non-tradable shareholders are not artificially revalued.

Alternatively, a company can increase its share capital through the conversion of a portion of its capital reserve. The non-tradable shareholders surrender the new shares issued pursuant to the capital increase to the tradable shareholders. In addition, tradable shareholders can receive a put option to sell back shares at a protected price to the current controlling shareholder, a government agency. The

218 The term 'ownership segregation' or 'equity separation' refers to the phenomenon that state shares and legal person shares are not allowed to be freely traded in the Chinese secondary stock market, hence segregated from publicly tradable shares, such as individual shares and foreign capital shares.

controlling non-tradable shareholders of a company agree to be bound by more stringent lock-up restrictions than those required by the CSRC circular. Many controlling shareholders agreed not to, during a specified period, sell the converted shares at a price that is lower than a specified minimum price. The controlling shareholders and holders of non-tradable shares in the trail stage are primarily public sector entities.

Ancillary circulars issued by the CSRC regarding the pilot reform scheme facilitate stock redemption programs in support of public securities prices. These circulars also waive the mandatory tender offer rules in connection with share purchases by a controlling shareholder aiming at stabilizing stock prices in furtherance of a conversion plan. The State Council and the State Administration of State-owned Assets Supervision issued the Reform Regarding the Split Share Structure of State-controlled Listed Companies Guiding Opinions on 17 June 2005, which laid down the criteria for setting the minimum shareholdings of the state among state-controlled listed companies after the split share structure reform. The shareholding structure of the listed company should be determined by the relative importance of the sectors that include listed companies and by the objectives of the state by holding shares in the companies.[219] The state's shareholding should be further adjusted in an orderly and standardized manner.[220]

The implementing rules of the 2005 Circular Number are the Administrative Measures for the Split Share Structure Reform of Listed Companies, issued and effective as of 4 September 2005, which provide the principles, operation sequence, requirements for reform plans, the selling of converted shares, information disclosure, functions of intermediaries, and regulatory measures. The Administrative Measures marked a fundamental step forward in the integration of China's domestic stock markets. In December 2005, the MOFCOM, the CSRC, State Taxation Bureau, SAIC, and SAFE issued the Administrative Measures for the Strategic Investment in Listed Companies by Foreign Investors. The new listing rules issued by the CSRC in 2006 also facilitated the split share reform. After the implementation of these new rules and regulations, the institutional shortcomings and weaknesses of China's stock exchanges may be removed and the market unification and fluidity may be further improved.

One year after the promulgation of the 2005 Circular Number, the resumption of listing activities in the A share market brought out a new round of expansion. It was reported that the market capitalization of the Chinese stock market

219 Reform Regarding the Split Share Structure of State-controlled Listed Companies Guiding Opinions, art 3.

220 Reform Regarding the Split Share Structure of State-controlled Listed Companies Guiding Opinions, art 5.

increased by 94 per cent by the end of 2005, and[221] 1,396 companies were listed on the Shanghai and Shenzhen Stock Exchanges in November 2006 with a total market value and float market value of RMB 5.228 trillion and RMB 1.799 trillion, respectively.[222]

Strategic Investment by Foreign Investors in Listed Companies

The Ministry of Commerce, the CSRC, SAIC, SAFE, and the State Administration of Taxation issued the Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors ('Circular Number 28') on 31 December 2005 effective 30 January 2006. The Measures, together with the Matters relevant to the Administration of Foreign Capital involved in the Reform of the Division of Equity Interests of Listed Companies Circular, jointly issued by MOFCOM and the CSRC effective 26 October 2005, introduced the concept of 'foreign strategic investors'. Such investors are allowed to acquire tradable A-shares of China-listed companies that have reformed their share capital structure under the Administration of Listed Companies Stock Right Allocation Reform Method, issued by the CSRC on 4 September 2005.

Before Circular Number 28, merely a limited number of foreign financial institutions holding a qualified foreign institutional investor status could legally purchase tradable A-shares of PRC-listed companies. Foreign investors without a QFII status could only acquire a stake in listed companies by privately purchasing non-tradable state holdings. Circular Number 28 targets a totally different type of equity investment and subjects strategic foreign investments to much lower entry requirements and to fewer investment restrictions than QFIIs.

For example, unlike QFIIs, which are not allowed to hold more than 10 per cent of the issued share capital of a listed company, Circular Number 28 requires a foreign strategic investor to acquire a minimum of 10 per cent of all the shares of the target listed company,[223] which technically allows strategic foreign investors to control a listed company.

Circular Number 28 sets out the thresholds in terms of capital scale, managerial experience, and operational history for foreign investors to meet in such investment with the aim of introducing advanced managerial skills and technology into China as well as improving corporate governance of Chinese listed companies.[224] However, Circular Number 28 imposes the following restrictions:

221 Editorial, 'The Market Capitalization of China's Stock Market Exceeding RMB 6.29 Trillion and Increasing by 94 per cent Over Last Year', *Beijing Youth Daily*, 5 November 2006.

222 See http://www.csrc.gov.cn, 26 November 2006.

223 Circular Number 28, art 17.

224 Circular Number 28, arts 1 and 6.

- The foreign strategic investment is still subject to the Foreign Investment Industrial Guidance Catalogue as well as the ceiling percentages set out in any industry-specific regulations.[225]
- The foreign strategic investment can only be made in the few listed companies that have fully implemented the Pilot Reform Scheme.
- The shares acquired by a foreign strategic investor, whether by private share transfer or private placement, are subject to a three-year lockup period unless specifically approved by the MOFCOM.[226] After the three-year lockup period, the listed company must obtain MOFCOM approval regarding the change of its share capital structure if the foreign strategic investor wants to exit.

Instead of imposing onerous qualification requirements on strategic investors, Circular Number 28 introduces very investor-friendly qualification requirements. The foreign investor (or its holding company) must own offshore assets of at least US $100 million or manage offshore assets of at least US $500 million. Circular Number 28 expressly allows a foreign investor to make a strategic investment in a PRC-listed company through a 'wholly owned subsidiary located outside China', even where the subsidiary would not itself company with the qualification requirements. However, the parent company must commit itself to take joint and several liability with its wholly owned offshore subsidiary. Under Circular Number 28, a strategic investor can perform the following to make a strategic investment:

- A private share transfer agreement between existing shareholders and the foreign investor;
- A private placement by the listed company to the foreign investor; or
- Any other method as allowed by PRC law.

Circular Number 28 is not clear about the nature of the 'other methods'. The PRC Securities Law uses a similar expression and refers to a general takeover offer as 'a method allowed by PRC law'. However, the foreign strategic investors are not likely to purchase a significant stake directly in the secondary market, at least in the short term. In any event, foreign strategic investors will not obtain controlling stakes in PRC-listed companies before 2008 by private share transfer. The shares which are open to foreign strategic investors are shares under the Pilot Reform Scheme which started in April 2005.

Such shares are subject to a full-year lockup period. In the 12 months following the end of this lockup period, holders of such shares will only be allowed to trade up to five per cent of the company's total shareholding, and up to 10 per cent in the following 24 months. Only after these three years are the shareholders allowed to transfer significant controlling stakes to foreign investors. A feasible means to achieve this may be through private placements

225 Circular Number 28, art 5.
226 Circular Number 28, art 18.

where listed company privately issues new shares to a designated investor. The private placement must comply with various conditions imposed in the Company Law, Securities Law, and other regulations.

Under Circular Number 28, only an acquisition by share transfer which results in the foreign investor becoming a controlling shareholder of the listed company will be subject to the general offer requirement. By contrast, if an acquisition by private placement results in the foreign investor becoming a controlling shareholder of the listed company, the acquisition is subject to a general offer requirement under the PRC Securities Law. In such case, the strategic investor can apply to the CSRC for a waiver of the general offer obligation under the Measures for Administration of the Takeover of Listed Companies 2002.

Circular Number 28, the Securities Law, and the Takeover Measures adopt different trigger events for a general offer. Circular Number 28 refers to 'effective control' as the trigger of the general offer requirement while the Securities Law and the Takeover Measures refer to a 30 per cent shareholding. As a result, even if the 30 per cent threshold is not reached, a foreign strategic investor may still have to satisfy the requirement to make a general offer if it has an 'effective control' in the listed company.

The greatest concern arising out of Circular Number 28 is the lack of flexibility regarding the method of payment for the acquisition. According to Circular Number 28, the payment of the acquisition price must be made in foreign currency and no other payment method is mentioned. Even though Circular Number 28 allows the foreign acquirers to make payment in instalments, the transaction is required to be completed within 180 days of receiving the MOFCOM approval. Circular Number 28 does not appear to be flexible with the foreign acquirer's paying with its own shares.

Takeovers

Takeover Transactions

Under the takeover rules and Securities Law, there are five ways to conduct a takeover of a PRC-listed company: takeover by a tender offer; takeover through a share purchase; takeover through private placement by the target company; indirect takeover; and takeover through trading on the stock exchange.

These five transactional means can be used alone or in combination. Under Chinese law, private placement or share purchase can be conducted through the strategic investment regime, while trading on the stock exchange is carried out via a qualified foreign institutional investor.

Takeover by Offer

Through takeover by offer, an investor can publicly request listed shares off the stock exchange. However, the purchaser should acquire at least five per cent of

all the outstanding shares of the target company in order to proceed with the transaction as a takeover by offer.

There are two types of offers: the tender offer voluntarily launched by the purchaser; and the mandatory offer triggered above the 30 per cent shareholding cap. A mandatory offer will be triggered in the event of a further shareholding increase following the reach of the 30 per cent shareholding or a takeover that will lead to the purchaser's shareholding in the target exceeding the 30 per cent threshold. The purchaser may obtain an waiver from the CSRC to be exempted of such a mandatory offer.

An offer can be a general or partial offer. A general offer targets all the outstanding shares while a partial offer only targets a portion of the outstanding shares.[227] The purchaser should extend a general or partial offer to all the shareholders. The general principle is that, in a takeover by offer, the purchase should treat all the shareholders equally and fairly, and acquire shares from shareholders on a pro rata basis if the number of shares to be sold exceeds that to be acquired.[228] In a voluntary offer, it is the purchaser who decides to launch either a general or partial offer. The situation may be more complicated in a mandatory offer.

The purchaser may launch either a general or partial offer to conduct the takeover if the mandatory offer is triggered due to the further shareholding increase following the reach of the 30 per cent shareholding threshold. However, the purchaser may only launch a general offer if the mandatory offer is triggered in the event of a takeover resulting in the reach of the 30 per cent shareholding threshold.

Takeover by a share transfer agreement must be conducted through the stock exchange. OTC transfer of listed shares is not allowed. The Chinese stock exchange and clearing house only accepts a takeover or transfer of shares if (i) a transfer acquiring the controlling rights of a listed company or resulting in a shareholding change of five per cent or above; (ii) a transfer between the parties who have a *de facto* controlling relationship or are both controlled by the same person; (iii) a transfer that constitutes a strategic investment by foreign investors; or (iv) a transfer otherwise recognized by the CSRC. Thus, a takeover by a share transfer agreement, as a matter of fact, refers to an acquisition of at least five per cent of the outstanding shares, which may be one of the following three scenarios: (i) an acquisition of shares from five per cent to 20 per cent; (ii) an acquisition of shares from 20 per cent to 30 per cent; or (iii) an acquisition of shares over 30 per cent.

In an indirect takeover, a purchaser indirectly controls or owns interests in a listed company. An indirect takeover may take place through (i) entering into an investment relationship with the listed company's shareholder, such as incorporating a special purpose vehicle with shares in the target company; (ii)

227 Securities Law, art 88.
228 Securities Law, art 88; Company Law, art 127.

entering into a contract or arrangement with the listed company; or (iii) acquiring the controlling rights in the listed company's shareholder by (a) acquiring equity or shares from an existing shareholder of the listed company's shareholder; or (b) subscribing for the new shares or capital increase of the listed company's shareholder. The last scenario is an acquisition of non-listed company.

Takeover Procedures 2002

The CSRC issued the Administration of the Takeover of Listed Companies Procedures (the 'Takeover Procedures') in October 2002. The Takeover Procedures cover a wide variety of transactions in which actual control in the listed companies may be acquired.[229] Transactional models may include negotiated purchases, tender offers, and competing trading at the stock exchange.[230]

Where an investor intends to hold or control more than 30 per cent of the outstanding shares in the target company, the investor is required to make a general offer to all the shareholders in the target company. The investor actually controls a listed company if:

- He is the single largest shareholder;
- The voting rights being exercised or controlled by him are more than those exercised by the largest shareholder of the company;
- He holds or controls more than 30 per cent of the shares or voting rights in the company;
- He has the right to appoint more than half of the board seats by exercising the voting rights; and
- In other circumstances determined by the CSRC.[231]

In a negotiated acquisition, the purchaser is to submit a report to the CSRC on the day following the conclusion of a takeover agreement, and provide a specified notice about the proposed transaction to the target and the public.[232] The board needs to make a decision after receiving the notice.[233] When the target of the transfer is state-owned shares, the government approval is required to effect the transaction.[234]

An existing shareholder holding less than 30 per cent of the shares in the target company also may increase its stake in the company through a tender offer, which, however, subjects the acquirer to some restrictions. For instance, the

229 Takeover Procedures 2002, art 2.
230 Takeover Procedures 2002, art 3.
231 Takeover Procedures 2002, art 61.
232 Takeover Procedures 2002, art 12.
233 Takeover Procedures 2002, art 15.
234 Takeover Procedures 2002, art 16.

shares to be purchased pursuant to such tender offer could not exceed five per cent of the outstanding shares, and the acquirer cannot hold more than 30 per cent of total shares after the takeover.

If the 30 per cent cap is exceeded, the acquirer is required to make a notification to the target company, make a public announcement, and submit an acquisition report to the CSRC.[235] The target's board may engage an independent financial adviser to assess its financial conditions, and opine the fairness of the offer. The board needs to make a recommendation to the shareholders and make such a recommendation available to the public and the CSRC.[236]

Upon its effectiveness, the takeover offer opens for a period of no less than 30 days but, save in the event of a competing offer, no more than sixty days.[237] The offer price cannot be lower than the highest price that the same purchaser had paid in a previous acquisition of the same class of shares within six months prior to the reminder date of the takeover offer.[238]

The payment for a takeover transaction can be made in cash, securities, or both. Nevertheless, the purchaser must pay the price in cash if it issues a general offer for the purpose of delisting the target company or as a result of its failure to obtain the CSRC exemption of a mandatory offer. Under the Takeover Procedures, the target cannot take such anti-takeover actions as issuing new shares, issuing convertible bonds, redeeming the company's shares, amending the company's articles, or selling all or substantially all of the assets if the purpose of one or more of these actions is to frustrate the takeover.[239]

Takeover Procedures 2006

The CSRC issued the new takeover procedures on 1 August 2006 (with the effect from 1 September 2006) to replace and consolidate the Takeover Procedures 2002 and the Administration of Disclosure of Information on the Change of Shareholdings in the Listed Companies Procedures.

Under the Takeover Procedures 2006, an investor holding more than 30 per cent of a listed company is only required to offer to buy part of outstanding shares.[240] The relaxation of the general offer rule is to encourage and facilitate more acquisitions. The CSRC is granted with the authority to overrule the poison-pill mechanism.[241] Consideration paid by the acquirer can be in the form of cash, securities, or their combination. Share swap, as a transactional mode, is now also allowed.[242] In the bidding process, potential purchasers must offer more than any

235 Takeover Procedures 2002, art 23.
236 Takeover Procedures 2002, art 31.
237 Takeover Procedures 2002, art 37.
238 Takeover Procecures 2002, art 38.
239 Takeover Procedures 2002, art 33.
240 Takeover Procedures 2006, art 23.
241 Takeover Procedures 2006, art 10.
242 Takeover Procedures 2006, art 36.

bids they have made over the preceding six months.[243] The new Takeover Procedures increase the transparency, strengthen the regulation of controlling shareholders and protection of minority shareholders, offer more transactional models, and reduce takeover costs.

Prohibitions on Transfer

Shareholders who have acquired shares in a listed company pursuant to the relevant articles under the section headed 'Acquisition of Listed Companies' may not dispose of the shares during the period of acquisition.

Conclusion

Although the history of China's modern securities market is brief, the progress made so far has been remarkable. The growth of China's securities market also is part of China's transformation from a socialist planned economy to a market economy. The early stage's institutional designs focusing on the SOE reform and maintaining state control have gradually given way to more market-oriented legal principles, concepts, tools, and measures. In this sense, it is plausible to see an expanding body of regulatory and trading rules, judicial guidelines, and interpretations as well as more legal measures to adjust or correct institutional deviations of the securities market.

Nevertheless, it may be still too early to conclude that the growth of the securities market and development of a legal or regulatory regime are on the right track. The largest hurdle is the state control and ownership, which will continuously affect the performance, functioning, and liquidity of the securities market. A more flexible registration regime should be put in place so that the level of the state intervention can be decreased to a further lower level. The disclosure regime should be further improved to allow investors to make informed decisions.

China's weak judiciary is still a source of criticisms, especially from the foreign investment community. Chinese courts have been more actively involved in the securities-related disputes. The Supreme People's Court has issued a wide range of judicial opinions, interpretations, and guidelines. Instead of its once lay-back approach, the Supreme People's Court instructed lower courts to accept and hear civil compensation cases arising from fraudulent activities in the securities market from January 2002. Nonetheless, the scope of cases that can be accepted and heard by the courts is still limited; and the eligibility of shareholder investors for compensation of losses suffered as a result of false statements also is limited. In a larger context, it appears that the court's role in China's social and economic development is not well placed and has more room for improvement. The courts in China, in general, may have to reach various goals

243 Takeover Procedures 2006, art 35.

by taking a more balanced approach. For instance, courts may have to strike a balance between upholding legal rights and interests under the law and being more responsive to the policy changes initiated by the government; between protecting lawful investments on the stock exchanges and cracking down on illegal or fraudulent activities; between supporting the principle of freedom of contract and intervening in the market behaviors at a reasonable level; and between offering sufficient and timely protections to investors when they suffer losses and maintaining social stability and harmony. These multi-faceted concerns raise challenges to a less developed judiciary in China. A well-educated, highly experienced, transparent, and independent judiciary is still the goal of further judicial reform, which will give more confidence to investors, domestic and foreign.

Given the infancy of the Chinese securities market, speculative activities have been widespread not only on the stock exchanges but also future markets as well as bonds market. The Chinese securities market is still dominated by individual investors. In the early years of its development, there were some occasions when individuals took to the street and rioted against police for the scarce opportunity to obtain subscription forms so that they were able to subscribe for shares. Starting from the 1990s, individual investors relied more on civil litigation for their claim of losses from the false statements.

This sort of litigation is likely to involve a large number of investors in the marketplace, and may have a negative impact on social stability. Both the regulatory watchdogs and courts have been careful in dealing with and having a mixed attitude towards such cases. In addition to the investor education campaign, the involvement of foreign investors also may help raise the investor community's sophistication level. In post-WTO China, along with China's further opening to foreign investors and fulfilment of its WTO commitments, it is reasonable to expect more and more foreign securities investments to come into China. Further legislative, institutional, and judicial reform of China's securities market and regulatory system will help strengthen investors' confidence and market efficiency.

Colombia

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Colombia

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Introduction

In General

Recent changes in Colombian capital markets regulations reflect Colombia's newfound economic prominence and increased level of financial sophistication. Colombia's impressive current growth rate, its reliable legal framework, and its highly developed institutional and retail investors have all contributed to significantly boost the interest of leading global financial institutions in Colombia.

This chapter, after providing a general overview of the securities markets in Colombia, focuses on legal order and regulatory interests with special regard to situations involving foreign elements, which include, among others, information on specific regulations applicable to foreign direct investment and the implications of the Colombian foreign exchange regime on the offering of crossborder financial and securities market products and services, and on procedures involving multi-jurisdictional securities offerings as well as particular rules applicable to offerings made by multilateral credit agencies and foreign entities and branches of foreign entities.

This chapter also includes a general review of the control and supervision of the securities markets, the main regulatory bodies, and participants, and provides a description of the overall structure of the Colombian securities markets, information on trading systems, as well as a description of the multi-phased integration of the Colombian, Peruvian, and Chilean stock exchanges and recently the Mexican stock exchange to form the *Mercado Integrado Latinoamericano* (MILA). The most important laws and decrees that regulate Colombia's Capital Markets include:

- Law Number 964 of 2005 (the 'Securities Market Law'), which regulates the intervention of the Government in the securities markets and implements an administrative structure that promotes transparency and allows fair participation of investors and other participants in the securities market; and
- Decree Number 2555 of 2010, which compiles prior decrees and regulations in the area of finance, securities, and insurance and provides extensive

regulation on the issuance, offering, and trading of securities, applicable to both local and foreign issuers.

Finally, this chapter provides an overview of corporate governance practices and their applicability to issuers, a description of the regulatory framework on the prevention of insider trading, a brief description of pooled funds and private equity funds, and an introductory analysis for the resolution of jurisdictional conflicts in Colombia under the principles of international commercial law.

Regulation and Supervision of Securities Markets

In General

The following three entities regulate and supervise the securities markets in Colombia:

- The Congress of the Republic enacts legislation to regulate activities in the securities markets;
- The Ministry of Finance and Public Credit (the 'Ministry of Finance'), which is part of the executive branch, has rule-making authority and issues regulations to enforce the securities laws enacted by Congress; and
- The Colombian Superintendence of Finance (the 'Superintendence') issues instructions to ensure compliance with the rules issued by the Ministry of Finance.

The main functions of each of these entities are described below. Several private entities also perform regulatory functions and their roles and responsibilities also are described below. Furthermore, the Colombian Central Bank exercises certain regulatory powers that may occasionally impact transactions effected in the securities markets, mainly in the context of the prevention of money laundering and the regulation of foreign exchange markets.

Congress

The Colombian Constitution assigns the Colombian Congress the power to enact legislation to provide the general principles and objectives regarding intervention criteria that the Administration must pursue when it issues regulations pertaining to the utilization, management, and investment of funds raised from the public. In the exercise of its constitutional powers described above, Congress enacted Law Number 964 of 2005, setting forth the legal framework applicable to the securities markets. The Law mainly regulates the following matters:

- The general principles and objectives of the Colombian securities market;
- The criteria for the government’s involvement in the securities markets;

- The definition of 'security' and the financial instruments that constitute securities;
- The description of the activities defined as 'activities of the securities market' and the requirement of being supervised by the Superintendence;
- The rules related to the so-called Integrated Information System of the Securities Market (SIMEV);[1]
- The procedures for offsetting and settling securities and the rules related to the central counterparty risk mechanisms;
- The general rules regarding depositary activities;
- The general rules of self-regulation in the securities markets;
- The general aspects on the protection of investors, including standards of good corporate governance; and
- The general regulations regarding administrative infringements and penalties.

Ministry of Finance

Pursuant to the Colombian Constitution, the President of the Republic has the power to regulate the securities markets in accordance with the legislation enacted by Congress (Law Number 964 of 2005). This authority was delegated to the Ministry of Finance and is exercised through the issuance of regulations.

The Ministry of Finance issues rules and regulations pertaining to the securities markets to affect the intent of the securities laws enacted by the Congress. Decree Number 2555 of 2010 presents the most extensive set of securities regulations issued by the Ministry of Finance. The Decree is a compilation of prior decrees regarding financial, securities, and insurance regulations. The Decree also updated certain rules related to the investment regime of pension funds, pooled funds and private equity funds, public offerings, and rules related to the activities of the SIMEV.

Superintendence of Finance

The Superintendence is responsible for the inspection, surveillance, and control of the participants in the securities markets. The Superintendence has the authority to execute financial regulations, conduct inspections, and supervise all financial entities and the activities of companies in the securities markets, including certain corporate procedures.

1 The SIMEV consists of three independent registries: (a) the National Registry of Securities and Issuers, (b) the National Registry of Agents of the Securities Market, and (c) the National Registry of Professionals of the Securities Market. In essence, the SIMEV collects relevant information that securities market participants must provide regarding their activities in the securities markets.

Other Entities with Regulatory Authority

Self-Regulatory Organization of the Securities Market. Law Number 964 of 2005 provides for self-regulation of the securities markets through the creation of the Self-Regulatory Organization of the Securities Market (*Autoregulador del Mercado de Valores*, AMV). The AMV is a non-governmental entity that exercises self-regulatory functions, including:

- Regulating intermediation activity in the securities markets;
- Ensuring securities-regulation compliance by intermediaries; and
- Imposing fines on intermediaries for violations of the securities regulations.

Colombian Stock Exchange. The Colombian Stock Exchange *(Bolsa de Valores de Colombia*, BVC) is a private entity organized as a corporation that administers the trading systems where securities are publicly traded and securities operations are registered. Pursuant to article 25 of Law Number 964 of 2005, stock exchanges such as the BVC perform certain regulatory, surveillance, and disciplinary functions.

Even though the BVC can issue its own regulations in connection with securities trading and other transactions made through the BVC, these regulations, such as the General Regulation of the BVC (*Reglamento General de la BVC*), require prior approval of the Superintendence. The regulations issued by the BVC in general terms provide for:

- Requirements for registration with the BVC;
- Certain procedural aspects regarding the prevention of money laundering by members of the BVC; and
- Certain technical aspects applicable to transactions conducted through the electronic trading systems managed by the BVC.

Securities Market Structure

In General

The securities markets are mainly comprised of issuers, investors, and facilitators or intermediaries between the issuers and investors (ie, brokers and dealers). A general overview of the structure of the Colombian securities markets is provided below.

Issuance and Negotiation: Primary Market and Secondary Market

Transactions involving securities that are purchased directly from the issuer are conducted on the primary market (*Mercado Primario*). On the secondary market (*Mercado Secundario*), investors purchase securities from other investors, rather than purchasing securities directly from the issuer.

Qualified Investors and General Public

Qualified or professional investors are investors that have a net worth equal to or greater than 10,000 times the current monthly legal minimum wages[2] and meet at least one of the following requirements:

- Ownership of an investment portfolio equal to at least five thousand (5,000) times the current legal minimum wages; or
- Execution of 15 or more securities transactions over a 60-day period, within two years prior to the respective investor's qualification as professional investor for aggregated value equal to or greater than 35,000 times the current monthly legal minimum wages.

Qualified or professional investors have exclusive access to the so-called *Segundo Mercado*, which is comprised of securities issued by a specific procedure with fewer requirements than the ordinary procedure applicable to securities placed in the so-called *Mercado Principal*; which can be accessed by the general public. Notwithstanding the foregoing, the general public may participate in certain *Segundo Mercado* securities transactions, such as:

- The purchase or sale of shares or bonds mandatorily convertible into shares undertaken by the shareholders of an issuer;
- The issuance of shares or bonds mandatorily convertible into shares in connection with the exercise of preemptive rights; and
- The purchases made by the issuer of its own shares after they have been issued and acquired by investors (repurchase of shares).

With prior authorization of the Superintendence, securities that are purchased or sold on the *Segundo Mercado* may be transferred to the *Mercado Principal*. However, securities that are purchased or sold on the *Mercado Principal* may not be transferred to the *Segundo Mercado*.

Qualified professional investors also have exclusive access to foreign securities trading systems administered by local stock exchanges. The foreign securities trading systems consist of securities issued by foreign issuers in accordance with foreign law and listed on a local stock exchange, provided that such securities meet the securities requirements provided by article 2 of Law Number 964 of 2005.

Given the limited use that investors and issuers have been given to the *Segundo Mercado*, the Ministry of Finance decided to make the current regime more flexible in order to encourage the participation of new issuers (including small and medium-sized enterprises) and, by means of Decree Number 1019 of 2014, it eliminated certain information requirements, and facilitated registration procedures, which in turn translated into a reduction of costs to the issuer. Under

2 The monthly legal minimum wage valid through 2014 is COP $616.027.

Decree Number 1019, for instance, the risk rating of securities issued in the *Segundo Mercado* is no longer mandatory.

Trading Systems: Stock and Over-the-Counter Market

Stock market transactions are conducted on a stock exchange or through securities trading systems. A stock exchange is a corporate entity authorized by the Government to act as a platform on which its members trade securities and provides its own set of regulations (ie, listing requirements), supervision, and services specifically aimed at facilitating securities trading.

Only the intermediaries of the securities market have direct access to securities trading systems and can execute transactions either as brokers (only stock broker companies and trustees) or on their own behalf (all intermediaries). Intermediaries of the securities market are entities subject to the supervision of the Superintendence, such as stock brokers, banking institutions, investment banks, trustees, pension fund managers, and insurance companies. The management of securities trading systems may only be undertaken by entities supervised by the Superintendence. In Colombia, the main securities trading systems include:

- The Colombian Electronic Market (*Mercado Electrónico Colombiano*, MEC), which trades fixed rate securities (ie, securities other than shares and convertible bonds) and is managed and regulated by the BVC.
- The X-Stream trading system, which trades variable rate securities and is managed and regulated by the BVC;
- The Electronic Trading System (*Sistema Electrónico de Negociación,* SEN), which mainly trades public debt securities and is managed by the Central Bank;[3] and
- The Foreign Securities Trading System (*Sistemas de Cotización de Valores Extranjeros*, SIC), which trades foreign securities listed on the SIC.[4]

In addition, pursuant to Decree Number 2555 of 2010, the request for the listing of foreign securities on the SIC may only be submitted by a Colombian broker in compliance with certain obligations, including:

- Provide the relevant information to the administrator;

3 Credit establishments, trust companies, stock brokers, independent securities brokers, pension and severance funds administrators, the National Treasury Department of the Ministry of Finance, and the Central Bank may access the SEN. SEN's users (agents) may act directly or through brokers.

4 Pursuant to Decree Number 2555 of 2010, the SIC is a multilateral and transactional mechanism, under which members agree to specific rules for the trading of foreign securities listed on the SIC. Only professional investors are able to conduct transactions in these foreign securities and only stock exchanges and administrators of securities trading systems that are under the Superintendence's surveillance may administer the SIC.

- Ensure that the market receives adequate access to the pertinent financial, accounting, and legal information, under the same conditions as such information is disclosed in the foreign market where the securities are traded; and
- Disclose the existence of administration and custody agreements of the listed securities with the local and foreign central depositary systems and custodians, if such is the case.

Securities depositaries that are under the Superintendence's surveillance are in charge of administering and serving as custodians of the foreign securities listed on the SIC. In Colombia, there are two depositary entities:

- The *Depósito Centralizado de Valores*, *Deceval*, which mainly is a depositary of securities issued by private companies; and
- The *Depósito Central de Valores del Banco de la República,* which is the public debt securities depositary.

The over-the-counter market consists of securities transactions that are not conducted through a securities trading system.

Bogotá, Lima, and Santiago Stock Exchange Integration

The MILA, which initiated operations in 2011, is a platform for variable rate securities trading of securities listed on the BVC, the *Bolsa de Comercio de Santiago (Chile),* and the *Bolsa de Valores de Lima (Perú)*. The *Bolsa de Valores de México* also plans on integrating with the MILA.

The MILA provides far-reaching investment opportunities to worldwide investors and increases the volume of transactions of variable rate securities in Latin America. The MILA's main characteristics in its current stage are the following:

- The ongoing integration of all four stock exchanges is not a corporate merger;
- Basically, each stock exchange has developed a different technological platform to operate in an integrated manner by means of a unique protocol of communication;
- Each market is autonomous, having its own regulatory framework and being administered by each stock exchange in their respective market; and
- The operations of the variable rate securities are performed through pre-authorized intermediaries and require the signing of agreements among them, with transactions being performed in the local currency of each market.

The integration of the Colombian, Chilean, and Peruvian stock exchanges has been structured into two phases:

- Phase I, which began in 2009, consisted of a series of cooperation and integration agreements between the relevant stock exchanges, depositaries, and governmental authorities of each jurisdiction; and

- Phase II, which is where the MILA stands currently, began in 2011.

Phase II applies the regulatory framework for the integrated market, the market's operational procedures, and any adjustments necessary. Once Phase II has concluded, the negotiation, offsetting, and settling of securities will be completely integrated.

Dual Listing

Colombian regulations allow for a foreign issuer to list its securities on the BVC, either through a dual listing procedure or by registering with the SIC securities trading system, as explained above. A dual listing provides a company with liquidity for its securities and allows it to expand its shareholder base to foreign institutional and retail investors. If an issuer has substantial operations in the country of its secondary listing, such presence and activities also may facilitate capital raising efforts.

Following registration with the National Registry of Securities and Issuers Registry (RNVE) and receiving the relevant authorizations from the Superintendence, a foreign company may publicly offer securities and register its securities with the BVC. Upon registration with the BVC, a foreign company becomes subject to local regulations of the Superintendence, the BVC, and Deceval.

Furthermore, securities trading on the secondary market is subject to compliance with Colombian foreign exchange regulations. Typically, a local depository agent will be appointed to keep shareholder records and distribute dividend payments. The SIC, as explained above, allows the securities of foreign companies to be listed and traded without prior RNVE registration or approval from the Superintendence. However, public offerings by foreign companies require prior RNVE registration, and only institutional investors have access to the SIC.

Foreign Investment and Crossborder Financial and Securities Services

International Investment

In General

Even though Colombia's legal framework strongly encourages foreign direct investment and has placed limited restrictions on foreign investment inflows and subsequent expatriation of investment proceeds, whether in the form of dividends or otherwise, foreign investors in Colombia and Colombian residents that invest abroad shall report their investments to the Colombian Central Bank to comply with the Colombian foreign exchange regime.

In essence, these reporting obligations are meant to assist in the prevention of money laundering and allow the Central Bank to analyze inbound and outbound investment flows for public policy purposes.

Legal Framework

Decree Number 2080 of 2000, amended by Decree Number 4800 of 2010, sets forth Colombia's foreign investment regime. For purposes of registration with the Colombian Central Bank, the Colombian foreign exchange regulations distinguish between portfolio investments and direct foreign investments.

Pursuant to Decree Number 2080, foreign investment in securities listed in the RNVE, pooled funds, and dual-listing schemes are considered portfolio investments. Moreover, Regulation Number DCIN-83 of the Colombian Central Bank (Regulation DCIN-83), in accordance with the amendments made by Decree Number 4800, establishes that foreign portfolio investments are short-term in nature. On the other hand, foreign exchange regulations establish that direct foreign investments where the investor wishes to attain control are long-term in nature. The following are considered direct foreign investments:

- Company capital contribution by means of the acquisition of shares, corporate quotas, or convertible bonds;
- Acquisition of real estate or securities issued as in connection with a real estate securitization or REIT;
- Acquisition of rights in trusts;
- Contributions by investors in respect of joint ventures and concessions;
- Capital or additional paid-in capital investments in branches of foreign companies; and
- Participation of non-residents in local private equity funds.

Pursuant to Regulation DCIN-83, local managers (eg, stock brokerage firms, trust companies, and investment management companies, known as *sociedades administradoras de inversión*) must be appointed as representatives of foreign portfolio investors, which are required to carry out the applicable registration requirements. Foreign investors who have duly registered their investments through a local manager have the right to repatriate invested capital and dividends or other types of distribution under the general foreign investment regime. Repatriation of funds must be made through the local manager by completing the relevant foreign exchange forms (Form Number 4 of the Colombian Central Bank). Broadly speaking, the following are the main obligations of local managers:

- Comply with foreign exchange regulations and registration requirements, including the registration of the portfolio investment with the Central Bank;
- Represent the foreign investor in all matters arising from its investments in Colombia;
- Comply with applicable tax regulations;

- Supply the Superintendence, the Central Bank, and any other relevant authority with any requested information; and
- Comply with any other obligations established by the Superintendence.

In order to make portfolio investments in Colombia, a foreign entity must enter into a management and custodial agreement with an authorized manager located in Colombia. The local manager acting on behalf of the foreign portfolio investor would be permitted to enter into repo transactions (*operaciones de reporto)*, buy-sell-back transactions (*operaciones simultáneas),* and stock-lending transactions (*operaciones de transferencia temporal de valores)* pursuant to articles 2.36.3.1.1 and 2.36.3.1.2 of Decree Number 2555 of 2010.

Additionally, the local manager would be permitted to enter into derivative transactions and provide collateral and guarantees in connection with said transactions or with any other operations or agreements that must be settled and liquidated through clearing houses. For these purposes, the local manager would be permitted to open and maintain checking and saving accounts to keep and dispose of the required assets and funds to enter into the authorized transactions.

Finally, Regulation Number DCIN-83 establishes the possibility of registering as a type of portfolio investment accounts payable and other amounts that foreign direct investors may be allowed to repatriate from Colombia derived from dividend payments or any funds arising from the liquidation or disposal of their Colombian investments.

Custodial Agreements

Custody, safekeeping, and nominee services of securities in Colombia are regulated by Decree Number 2555 of 2010, modified by Decree Number 1243 of 2013, which set forth a new set of rules regarding the custody of securities. Custodial activities undertaken in Colombia are governed by three basic principles:

- Independence;
- Segregation; and
- Professionalism.

In order for the client to contract a custodian, the two parties must enter into a custody agreement for the purpose of regulating the activities to be performed by the custodian and the respective fees to be paid for the services. Under Decree Number 1243, the custodian, which is the local entity that undertakes the custody of securities, is obligated to perform three mandatory services:

- Perform the safekeeping of securities;
- Take care of the compensation and liquidation of the securities operations; and

- Manage the financial rights derived from those securities.

In order to obtain authorization to act as a custodian, the local fiduciary entity must be registered with the National Registry of Agents of the Securities Market (*Registro Nacional de Agentes del Mercado de Valores*) administered by the Superintendence. The custodian also must comply with several other requirements. Finally, the custodian must be liable for the securities and cash that are under its custody, for the rendering of the mandatory, supplementary, and special services, as well as for the compliance of its legal and contractual obligations, for which it would be responsible up to negligence as a prudent and diligent expert, in the securities custodial activity.

Offering Crossborder Financial and Securities Services

Regulatory Framework

Pursuant to Decree Number 2555 of 2010, a foreign entity whose main purpose is to offer financial, reinsurance, or securities-related services and intends to promote, market, or advertise its products or services in Colombia (a 'foreign entity') must either establish a representative office in Colombia or enter into a referral agreement with a local broker-dealer (*sociedad comisionista de bolsa)* or with an investment bank (*corporación financiera*). In order to establish a representative office, the foreign entity is required to file an application with the Superintendence.

Once a foreign entity has established a representative office, other affiliates of the said entity may file an application to be represented by the same representative office. Under applicable regulations, any foreign entity that has not established a representative office in Colombia, or executed a referral agreement, is barred from undertaking any of the following activities in Colombia:

- Promote or advertise, directly or indirectly, any financial and securities-related products and/or services within Colombia and to any Colombian residents; and
- Send employees, contractors, representatives, agents, or traveling salesmen to Colombia, or hire or contract Colombian residents to advertise or promote the foreign entity or its products and services.

Under applicable regulations, a representative office is only permitted to engage in the following:

- Undertake administrative activities which are directly related to the promotion and marketing of the relevant foreign entity or its financial or securities-related products; and
- Act as a liaison between the relevant foreign entity and its clients in Colombia by means of (a) the delivery to and receipt from the client of all documentation

required by the foreign entity for the rendering of financial or securities-related services; (b) advising clients on the risk they would undertake by entering into commercial relationships with the foreign entity; (c) instructing and informing the foreign entity's Colombian clients on the fees, costs, expenses, and tax implications of the foreign entity's financial or securities-related services; (d) as long as they have been granted the specific authority to do so, undertake the collection, in and out of court, of any monies owed to the foreign entity by Colombian clients with regard to financing granted to the client by the foreign entity; (e) undertake promotional and marketing activities on behalf of the foreign entity and its services; and (f) promote the foreign entity and its services within Colombia by means of so-called promotion offices, established under the relevant representative office's supervision within Colombia in places other than its main offices, and with the prior approval of the Superintendence.

Representative offices are expressly barred from carrying out, directly or indirectly, any onshore financial or securities-related activity, which requires the authorization of the Colombian authorities, such as the rendering of financial services or securities-related activities.

Definition of 'Promotion' or 'Marketing'

Pursuant to Colombian law, 'promotion' or 'marketing' means any communication or message, delivered personally or through other means, whether or not widely distributed, intended to initiate, directly or indirectly, financial activities.

The rules and restrictions pertaining to the Foreign Entities' offering of financial products in Colombia apply regardless of whether the financial products are to be offered privately or in connection with a public offering of securities or the financial products are offered to the public at large, qualified purchasers, or qualified institutional buyers.

Referral Agreements

Referral agreements are agreements entered into between a foreign entity and either a local broker-dealer or investment bank. In general, all the rules and requirements applicable to representative offices also apply to referral agreements.

The purpose of these agreements is to provide the terms and conditions under which the relevant local broker-dealer or investment bank will promote the foreign entity's securities-related products or services. Referral agreements can only be entered into by foreign entities that intend to promote their securities-related products and/or services. Like representative offices, referral agreements and any amendments to the agreement must be approved by the Superintendence.

Exceptions

Although the general rule is that foreign entities wishing to promote their financial, reinsurance, or securities-related services are required to establish a

representative office in Colombia or enter into a referral agreement, the applicable regulations establish exceptions to this general rule.

Multilateral agencies and foreign governmental entities, when arranging government-to-government financings, are exempted from this requirement. The same applies, subject to specific considerations, in the event of reverse solicitations.

Participants in Securities Market

In General

The participants in the securities market mainly include:

- Issuers;
- Investors; and
- Intermediaries who facilitate transactions between the issuers and investors.

Issuers

In General. The following types of legal entities may issue securities:

- Corporations;
- Foreign governments and foreign public entities;
- Multilateral credit agencies;
- Foreign entities and branches of foreign entities;
- Limited-liability companies;
- Cooperative entities;
- Non-profit entities;
- Trusts; and
- Pooled funds.

Corporations. Corporations may issue capital (shares) and debt securities. Upon the registration of shares with the BVC, the following implications result:

- Restrictions on the free transferability of shares are suspended, in particular any preemptive rights; and
- Quorum requirements and special majorities are modified, and the issuer becomes subject to specific regulations.

Foreign Governments and Foreign Public Entities. Foreign governments and foreign public entities are subject to a public law regime abroad and generally exercise some sort of public function. These entities may offer securities

publicly in the Colombian market subject to the following conditions set out in Decree Number 2555 of 2010:

- The Colombian government or Colombian public entities should be able to publicly offer for sale their securities in the securities markets of the foreign public entity's home country (ie, requirement of reciprocity);
- The foreign government or foreign public entity offering securities in Colombia or the securities that those entities wish to offer in the local securities market must be rated by one or more risk rating agencies that is internationally recognized and considered as such by the Superintendence or by a rating agency supervised by the Superintendence;
- When shares are registered, the issuer must disclose, and prove to the satisfaction of the Superintendence, the scope of corporate rights of any Colombian investors, as well as how such Colombian investors may exercise their corporate rights. The issuer also must disclose the corporate rights of investors residing in the home country of the issuer;
- The issuer must have securities registered with one or more internationally recognized stock exchanges, to the satisfaction of the Superintendence, prior to completion of the securities offering in Colombia; and
- To the extent required by the law of the issuer's home country (ie, the country where the issuer's primary office is located), the issuer must demonstrate to the Superintendence that the issuer's home country regulator has authorized the Colombian registration or offering of the issuer's securities.

Multilateral Credit Agencies. Multilateral credit agencies are entities formed by different countries with the aim to facilitate the extension of credit. According to Decree Number 2555 of 2010, these multilateral credit agencies may publicly offer securities in the Colombian market, subject to certain conditions, described in greater detail below.

Foreign Entities and Branches of Foreign Entities. Foreign entities that are not subject to public law may make public offerings of securities in Colombia pursuant to Decree Number 2555 of 2010, as long as they meet, among others, the same requirements outlined above In addition, branches of foreign entities that undertake permanent activities in Colombia may publicly issue securities, as long as they meet certain requirements as described below:

The branch of the foreign entity must have been operational in Colombia for at least three years. If the branch is in a pre-operational stage or has been operational for less than three years, it must submit to the Superintendence an economic, financial, and market feasibility study (*estudio de factibilidad económica, financiera y de mercado*) or, if the foreign entity will provide 'support' (ie, if the foreign entity will pay the investors in the event the branch fails to do so), the branch must demonstrate that the foreign entity has securities registered with one or more internationally recognized stock exchanges, as considered and acknowledged by the Superintendence, and that the term of maturity, if any, of the

securities publicly offered does not exceed the limit set for the duration of the branch's activities in Colombia. The prospectus and other documentation supporting the issuance must indicate whether the offering is guaranteed by the foreign entity and include at a minimum the following information:

- The scope of the liability of the foreign entity, in particular, whether the offering of the branch is wholly or partially guaranteed and whether the foreign entity's liability (*obligación*) is joint and several or secondary.
- The priority of payments to the holders of securities issued by the branch in the event of any universal insolvency proceedings, whether judicial or extra-judicial, against the foreign entity; and
- The law and jurisdiction governing the liability (*obligación*) of the foreign entity, including a description of the procedure to be initiated for extra-judicial debt collection or forced judicial liquidation.

Branches are required to periodically update their registration with the National Registry of Securities and Issuers (RNVE). If the foreign entity guarantees the offering, it must comply, through its branch, with the disclosure obligations of any relevant information, as provided in Decree Number 2555 of 2010 for all issuers, and with the reporting duties imposed on foreign entities through their Colombian branches.

Other Issuers. This group includes limited-liability companies, cooperative entities, non-profit entities, trusts, and pooled funds.

Securities Intermediaries

Intermediation

Intermediation activities in the securities market facilitate the purchase and sale of securities, either through the registered securities systems or in the over-the-counter market. The main purposes of these activities are:

- Purchase or sell securities that are listed on the RNVE, whether in the primary market or secondary market;
- Buy or sell securities that are traded on the secondary market and listed on the SIC;
- Undertake transactions in derivatives and structured finance products that are considered to be securities; and
- Buy or sell securities on the primary or secondary market, which are part of an integration of stock exchanges.

Securities Intermediaries

Intermediaries in the securities markets include stockbrokers, independent brokers, credit institutions, trustees, insurance companies, pension fund

managers, pooled fund managers, and stockbrokers of agricultural products and other commodities.

In addition, the public entities that, in accordance with their legal regime, are able to undertake securities transactions directly on securities trading systems may acquire the title of intermediary. This title necessitates a certain level of supervision by the Superintendence. These intermediaries are required to be members of the self-regulatory organization authorized by the Superintendence and are subject to the requirements imposed by such organization, as well as those derived from their registration with the National Registry of Agents of the Securities Market.

Investors

Pursuant to the provisions of Decree Number 2555 of 2010, the securities laws distinguish between professional or qualified investors (who have exclusive access to the *Segundo Mercado* and to the SIC) and client-investors, defined as those who are not professional investors. The conditions to be classified as professional or qualified investor are described above. However, a professional or qualified investor is enabled to withdraw that title voluntarily.

Securities Issuances and Public Offerings

As discussed above, securities that have been issued and which have not been previously publicly traded are negotiated on the primary market, while securities previously issued are traded on the secondary market. In the primary market, the issuer may offer securities through a public offering or a private placement.

In the secondary market, a seller may offer or a buyer may acquire securities through a securities trading system administered by a stock exchange or by the following special procedures:

- A public auction (*martillo*);
- A democratization offer (*oferta de democratización*); or
- Through public tender offer.

Public Offerings and Private Placements

Public Offerings

A public offering is one that meets the following conditions:

- The offering is addressed to the public at large or to 100 or more specifically identified investors; and
- The offering is made with the purpose of soliciting the general public for acquiring publicly issued securities that grant purchasers certain rights.

In contrast, a private offering generally meets the following conditions:

- The offering is addressed to less than 100 specifically identified investors;
- The offering is addressed to the shareholders of the issuing company, so long as there are less than 500 shareholders; and
- The issuer is a public utilities company that is offering securities to investors who will benefit from investments in infrastructure.

Securities that are to be offered publicly must be registered with the National Registry of Securities and Issuers and are subject to prior approval by the Superintendence. The specific content of the offering prospectus is set forth by Resolution Number 2375 of 2006 issued by the Superintendence.

The prospectus must include, at minimum, a description of the conditions and characteristics of the securities being offered, the terms of the offer, and the authorizations received. The prospectus also must contain a clear and complete description of the issuer, including information about its organizational aspects, historical background, financial information, expectations, risks, future projects, and plans for funds allocation received as a result of the issuance, among others.

This information, along with any additional information disclosed in the prospectus, must be certified by those responsible for generating it. Furthermore, the prospectus must be made available on the websites of the issuer, the Superintendence, and the BVC.

Private Placements

In Colombia, entities engaged in financial activities (ie, banks, insurance companies, finance companies, and financial corporations) are subject to the surveillance of the Superintendence, whereas issuers that are not engaged in financial activities are only subject to the supervision by the aforementioned authority. The Superintendence, under its supervisory powers over issuers, may only monitor the compliance of rules regarding the issuance and offering of securities. By contrast, the Superintendence under its surveillance power (which is a much broader power) may monitor the compliance of other types of rules, such as financial and corporate rules.

In general terms, in the event of private placements of equity securities, only entities subject to the surveillance by the Superintendence (eg, banks and insurance companies) and entities subject to the supervision by the Superintendence and other Governmental authorities must petition the Superintendence for its prior approval regarding the private placement rules of ordinary shares (*reglamentos de suscripción de acciones ordinarias*).

Entities subject to the exclusive supervision of the Superintendence (ie, entities that are not supervised by any other governmental authority) are not required to obtain prior approval of the Superintendence for the purposes of a private placement, regarding the private placement rules of ordinary shares

(*reglamentos de suscripción de acciones ordinarias*), as long as such placement complies with the following conditions:

- The number of shares to be placed is equal to or less than 20 per cent of the overall outstanding shares of the issuer;
- The placement is made subject to any preemptive rights the issuer's current investors may have;
- The placement rules comply with the specific requirements established in Decree Number 2555 of 2010; and
- The issuer has taken, as the case may be, the measures intended to preserve the rights of the holders of bonds mandatorily convertible into shares.

In addition, if the issuer complies with the above, its legal representative and fiscal auditor must submit to the Superintendence certain documents referred to in External Circular Number 005 of 2005 issued by such authority within 10 business days following the expiration of the term of the private placement. However, if any of the above requirements are not met, the specific exemption does not apply and the issuer must request authorization from the Superintendence.

Issuance of Securities by Colombian Residents Abroad

In General

Colombian issuers may currently engage in three types of public securities offerings in foreign markets:

- The exclusive public offer abroad;
- The simultaneous public offer undertaken both locally and abroad; and
- The successive public offer undertaken first abroad, in Colombia, or vice versa.

Through public securities offerings outside Colombia, Colombian issuers can access international capital markets to attract foreign investors and obtain additional funding for major operations or projects. Domestic issuers may offer securities registered with the RNVE and listed on the BVC locally and internationally, requesting authorization from the Superintendence in connection with the local offer, or register the securities in foreign trading systems without making an offer. In simultaneous public offerings, Colombian issuers may, with prior authorization of the Superintendence with respect to the local offering, offer their securities both in Colombia and abroad. For purposes of a simultaneous offering in Colombia and abroad, the issuer must have its shares listed on the BVC.

For purposes of granting the authorization, the Superintendence may accept international practices to facilitate the placement of the shares, including the price formation process (book-building) and the deadline for the offer. The

book-building process must be a technically recognized process and may be undertaken exclusively in the jurisdiction where the majority of shares will be offered.

In addition, issuers wishing to undertake a simultaneous public offer in the local and foreign markets may draft the prospectus in the language required by commercial practices and as established by the regulations of the market in which the offering will take place. However, copies of the prospectus to be distributed in Colombia and copies that must be filed with the RNVE must include a version containing, at least, the information set forth in Decree Number 2555.

In addition, the prospectus distributed in Colombia and/or filed with the RNVE shall include, in Spanish, the specific information required by the applicable regulations regarding the type of securities to be offered and other aspects that may be relevant for Colombian investors.

Furthermore, despite the fact that the prospectus may be in English (or in the language of the country where the offering will take place), it must include the specific provision establishing that the registration before RNVE and authorization of the public offer by the Superintendence does not imply certification of the merits of the securities or the solvency of the issuer by such authority. Accordingly, it is common practice that the prospectus is prepared with two columns, containing the pertinent prospectus information in both English and Spanish, and the language of the country where the offering is made.

American Depository Receipts and Global Depositary Receipts

Despite the fact that Decree Number 2555 of 2010 establishes the general conditions that Colombian issuers must fulfill if they wish to undertake public offerings in foreign markets, the manner pursuant to which they effectively achieve the placement of their securities in international markets will depend on the issuer's intentions regarding the level of disclosure obligations to which they want to be subject to the manner in which they decide to trade their securities, and the type of investors they wish to attract.

As an attractive alternative to public offerings in foreign markets, Colombian issuers may issue American Depository Receipts (ADRs) or Global Depositary Receipts (GDRs), which are among the most recognized international mechanisms for such purposes. ADRs are deposit certificates issued in the United States by a financial institution, usually a bank, which represent shares or convertible bonds issued by a non-United States issuer. GDRs share many characteristics of ADRs, however, for GDRs the underlying securities are deposited with several affiliates of a financial institution in different countries.

ADRs and GDRs allow foreign investors to invest in securities issued in different jurisdictions without having to consider any exchange and tax

regulations established in the issuer's home country. The following parties participate in the issuance and placement process for ADRs and GDRs:

- The Colombian issuer whose securities will be represented by the ADRs or the GDRs;
- The depository, which is the financial institution in the United States, or another country, as applicable, which issues the depositary receipts that represent the securities issued by the Colombian issuer;
- The custodian, which is the party that receives the underlying securities, with the purpose of holding them on behalf of the depository; and
- The investors that purchase the depositary receipts and acquire beneficial ownership in the underlying securities of the Colombian issuer.

In general, the depository exercises the rights granted by the underlying securities (pursuant to the specific instructions as established in the deposit agreement) and receives and distributes the Colombian issuer's dividends, in US dollars or the corresponding local currency, to the ADR or GDR holders.

Public Offerings of Securities by Foreign Issuers in Colombia

Regulations Applicable to Foreign Issuers and Their Securities Offerings

According to article 6.11.1.1.1 of Decree Number 2555 of 2010, the Superintendence may authorize the public offering of securities issued by foreign entities as long as certain requirements are met, as described above. Notwithstanding the foregoing, branches of foreign issuers incorporated in Colombia must comply with the additional requirements described above to conduct public offerings of their securities in Colombia. Furthermore, there are additional disclosures that the prospectus for such offerings by foreign issuers is required to contain, as stipulated in article 6.11.1.1.2 of Decree Number 2555 of 2010, including:

- A detailed description of the system or procedure to be used for the offering, indicating the placement entities, the locations where the registration is to be made, and the stock exchanges where the securities will be registered;[5]
- A definition of the legal regime applicable to the securities with an indication of the competent courts for the exercise of any legal action or procedure regarding compliance and forced execution of the obligations derived therefrom;
- A summary description of the tax regime applicable to the securities, as well as the foreign exchange and of international investments regimes applicable in the country in which the issuer has its main offices;

5 If the offering is to be placed in several markets, it is necessary to provide additional information regarding each of them.

- The designation of the agents that will receive any legal notifications on behalf of the issuer in Colombia;
- The safekeeping clause by means of which the rights of the holder and the obligations of the issuer are ranked at least *pari passu* in payment priority with all other direct debts of the issuer represented as securities, non-guaranteed and non-subordinated; and
- All other information that the Superintendence considers essential for the purposes stipulated by law.

Issuance of Securities by Multilateral Credit Agencies

According to article 6.14.1.1.1 of Decree Number 2555 of 2010, multilateral credit agencies can issue securities, subject to meeting the following requirements:

- The multilateral credit agency was created pursuant to an international treaty or agreement to which Colombia is a party;
- The securities issued by the multilateral credit agency must be at the order of or nominal, and a Colombian institution must be designated to act as administrator of the offering; and
- The multilateral credit agency must have obtained, in the 12 months immediately prior to the offering date, a rating of at least investment grade by one or more credit risk rating agencies, recognized as such by the Superintendence.

The rating must be kept up to date until the issuance is redeemed. The securities offered for issuance in Colombia do not have to be rated. The securities must be registered with a Colombian stock exchange. The registration of the securities issued by a multilateral credit agency with the National Registry of Securities and Issuers will permit the agency to make its public offering without payment for registration rights, public offer, or support fees. In addition to fulfilling the general prospectus requirements pursuant to Colombian securities laws, any prospectus for offering of securities by a multilateral credit agency must include the following:

- The identification of the issuer, noting its offices and main address, location of incorporation, as well as a brief description of its corporate constitution;
- A copy of the bylaws of the issuer or of the treaty acting as such;
- A detailed description of the system or procedure employed for the securities offering, indicating the markets where the securities to be issued will be traded, the placement agents, the location where subscriptions may be made, and the stock exchanges on which the securities will be registered;[6]

6 If the offering is made in several markets, such disclosures must be specified for each market.

- A description of the legal system governing the securities, indicating the competent courts for the exercise of any rights or procedures with respect to compliance and forced execution of the resulting obligations;
- A brief description of the tax framework applicable to the securities;
- The designation of agents for service of process in Colombia for any legal actions filed in Colombia;
- The safekeeping clause for which the rights of the holder and the obligations of the issuer are ranked at least *pari passu* in payment priority with all the other direct debt of the issuer represented in securities, non-guaranteed and non-subordinated; and
- Any other information that the Superintendence considers material.

In addition, pursuant to article 6.14.1.1.5 of Decree Number 2555 of 2010, the multilateral credit agency's securities offering must appoint a legal representative for the securities holders to represent their interests. The legal representative will be the only person authorized to exercise the rights stipulated in favor of the holders and institute legal actions against the issuer to enforce the securities holders' rights. For this purpose, the legal representative must sign an agreement with the issuer, which must contain the following stipulations:

- The rules and procedures that allow an appropriate communication between the securities holders and the issuer;
- The rules and mechanisms for holding meetings of securities holders when necessary;
- The quorum and majority rules at meetings of securities holders and the obligation of the legal representative of the securities holders to certify to the issuer that the decisions were made at the assembly subject to the rules; and
- The procedures for removal and replacement of the legal representative.

Multilateral credit agencies are not subject to the general reporting requirements of Decree Number 2555 of 2010. However, they must report immediately any information related to changes in their financial or operational affairs that may significantly impact their ability to repay the capital and interest payable with respect to the securities issued in Colombia. Finally, both multilateral credit agencies issuing bonds in the local market and foreign issuers in general must take into account the structuring of the operation regarding the design and content of the agreement involved in the respective issuance. To the extent the issuer, the structuring agent, and the underwriter are all foreign, foreign law and jurisdiction, usually the laws of the State of New York, can govern the underwriting agreement.

Notwithstanding the foregoing, to the extent the underwriting agreement is entered into with a Colombian lead manager and/or the placement group and/or distributor, or if the Colombian agent also acts as underwriter, the underwriting agreement can be made subject to Colombian law and jurisdiction. In any case,

the presence of an underwriter and an international issuer makes the content of the agreement to correspond to the standards and formalities characteristic of the foreign jurisdiction.

Generally, the underwriting agreement will contain relatively rigid clauses regarding the representations and warranties of the issuer, detailed clauses regarding compensation and contribution among the parties involved, additional obligations of the issuer, conditions for suspension regarding the obligations of the underwriters and the arranger, and the survival of certain clauses, and so on, which reflect the legal practices of even the most sophisticated securities markets.

Obligation to Disclose Material Information to the Market

Material Information

Pursuant to article 5.2.4.1.5 of Decree Number 2555 of 2010, issuers are required to disclose any material information to the market on a timely basis. The abovementioned article establishes two different standards to determine whether a reportable event requiring disclosure has arisen. The first standard broadly captures any information that would have been considered material by a diligent investor in connection with the purchase or sale of securities or with the decision to retain such securities as well as the exercise of securities holders' rights.

More specifically, Decree Number 2555 of 2010 provides a list of situations, decisions, and events that constitute material information. In connection with this list, the Superintendence has indicated that some of these events are presumed, as a matter of law, to constitute material information, while others require issuers to make judgment calls about the materiality of the specific situation to decide whether the information constitutes a reportable event. Pursuant to article 5.2.4.1.5 of Decree Number 2555 of 2010, the following types of situations or events constitute examples of material information requiring immediate disclosure by the issuer:

- Financial and accounting information, such as changes in the number of outstanding shares, approvals of dividend distributions, restatements of the issuer's financial statements, investments in companies, changes in accounting classification of investments or changes in accounting policies and disposals or acquisitions of any property whose value is equal to or greater than five per cent of the issuer's group of assets, as well as relevant changes in interest rates or other terms of credit or loans obtained and the capitalization of debts, mortgage encumbrances, pledges, or other collateral, payments in kind, and exchanges of assets or real properties; and
- Information as to legal status, such as calls for shareholder meetings; relevant decisions of the shareholder meetings and of the board of directors or equivalent; amendments to by-laws and any appointments, removals, and

resignations of any director or auditor; relevant judicial or administrative proceeding and any imposition of penalties, changes in control, changes in ownership of any shareholders in an amount equal to or greater than five per cent of the outstanding shares, acquisitions and disposals of securities by directors, and shareholder agreements; termination and amendments of agreements that may impose any restrictions on the issuer and granting or cancellation of concessions or licenses; employment information, including termination or amendments with respect to material employment agreements, including convention and collective labor agreements; introduction or launch of new products or services and any material intellectual property issues; changes in the issuer's core business, corporate reorganizations such as mergers, conversions, acquisitions, transfers of assets and liabilities, corporate crisis situations, such as defaults in obligations for a certain period, insolvency proceedings or any event which might lead to interruptions of the issuer's commercial activities, and takeovers for administration or liquidation; issuances of securities in Colombia or abroad and all related aspects including delays in fulfilling obligations arising from such issuances; and bondholder or investor meetings, assembly decisions, and resignations or removals of the legal representative of securities holders.

For purposes of securitizations, additional information must be disclosed. Article 5.2.4.1.5 of Decree Number 2555 of 2010 lists a number of additional situations. Furthermore, the Superintendence may request from issuers any other information it considers material to ensure and preserve the capital markets' transparency.

Form and Opportunity to Disclose Material Information

Material information must be reported through the website of the Superintendence immediately after the reportable event has occurred or after the issuer becomes aware of such event. In any event, the information must include a detailed description of the reportable event. Pursuant to article 5.2.4.1.8 of Decree Number 2555 of 2010, the legal representative of the issuer is responsible for reporting such material information to the Superintendence.

Pursuant to Decree Number 2555 of 2010, issuers may not report through mass media any material information without prior or simultaneous disclosure to the public by means of the Superintendence's mechanisms for dissemination. In the event such information is released, the issuer must inform the market about its veracity.

Sanctions for Not Complying with Disclosure Requirements

Pursuant to Law Number 964 of 2005, failure to disclose a reportable event in an accurate, timely, complete, and sufficient manner constitutes a violation of Colombian securities laws.

Non-Disclosure Authorization

Notwithstanding the above, pursuant to article 5.2.4.1.7 of Decree Number 2555 of 2010, the legal representative of the issuer may request from the Superintendence an exemption from reporting an event, on the grounds that its disclosure could harm the interests of the issuer or may affect market stability. In addition, information with respect to ongoing business negotiations is exempted from the reporting obligations imposed by law when the status of such negotiations could be negatively impacted by public disclosure.

However, the Superintendence has discretion to determine whether information about ongoing negotiations must be disclosed. As suggested by the wording of the relevant part of article 5.2.4.1.7 of Decree Number 2555 of 2010, the disclosure order is more likely in the event of significant price fluctuations, which cannot be explained by current publicly available information about the issuer. However, even if the securities are behaving as expected, the Superintendence may find additional reasons to require the disclosure of ongoing negotiations.

Sanctions for Disclosing Privileged Information

Article 5.2.4.1.7 of Decree Number 2555 of 2010 treats undisclosed information as privileged information. Therefore, if the non-disclosure request is granted by the Superintendence, the persons included in the list of individuals who have access to the privileged information may not engage in any securities transactions related to the affected securities until such privileged information is properly disclosed to the market.

Board members are usually included in the abovementioned list. Therefore, they are required to refrain from disclosing or using for personal gains such privileged information. In addition, article 50 of Law Number 964 of 2005 considers that the use or disclosure (ie, tipping) of any privileged information violates Colombian securities laws. Therefore, if a board member uses or discloses any privileged information, such person becomes subject to the sanctions established in article 53 of Law Number 964 of 2005. For instance, under article 53 of Law Number 964 of 2010, board members would be subject to the imposition of fines that may not exceed, as of 2014, COP $187,236,144.

Insider Trading

Insider Trading Penalties

Pursuant to article 75 of Law Number 45 of 1990, any person will be subject to sanctions if that person, directly or indirectly:

- Undertakes one or more transactions in the securities market using privileged information (as defined above);
- Provides privileged information to a third party who is not entitled to receive it; or

- Provides such privileged information to advice on the purchase or sale of securities.

Pursuant to articles 50 and 53 of Law Number 964 of 2005, the Superintendence may impose several sanctions. A natural person can be subjected to a fine not exceeding, as of 2014, COP $187,236,144; a legal entity can be subjected to a fine not exceeding COP $939,441,094. The fines are payable to the Colombian Treasury Department. Other sanctions may include:

- Suspension to act as corporate officer (ie, perform administrative, management, or control activities) for up to five years at entities subject to supervision by the Superintendence;
- Temporary or permanent removal (as the case may be) from administrative, executive, or financial position of any entities subject to supervision by the Superintendence;
- Suspension of the registration in any of the registries included or referenced in Law Number 964 of 2005;[7] and
- Cancellation of the registration in any of the registries included or referenced in Law Number 964 of 2005.[8]

Finally, under the Colombian anticorruption statute, an employee, director, or member of a board or management body of any private entity who misuses privileged information such person possesses, due to such person's position or function, to obtain a benefit for him/herself or third parties, will be criminally prosecuted (imprisonment from one to three years and fines) in addition to any fines imposed by the Superintendence. Professionals and advisors who come into possession of privileged information and use such information to obtain a benefit for him/herself or third parties, by means of the negotiation (trade) of securities registered in the National Registry of Securities and Issuers, will be subject to the aforementioned penalties, as well.

Investor Protections

Corporate Governance

In General. Corporate governance refers to the set of control and supervisory mechanisms adopted by issuers to allocate powers amongst shareholders,

7 Under this penalty, the Superintendence may either limit certain activities or limit all of them. Once the term of suspension expires, the registration will be re-established with full effect.

8 In this case, the affected person/legal entity will be barred from registering in any of the registries that comprise the Integrated Information System of the Securities Market (*Sistema Integral de Información del Mercado de Valores*, SIMEV). The cancellation may last from one to 20 years. Once the cancellation term expires, the affected person or legal entity would have to reapply for registration and undertake the respective registration process.

executives, and the board of directors, or the equivalent, with the ultimate goal of maximizing shareholder value.

In the international context, much of the corporate governance standards applicable to Colombian issuers of securities were developed by the Organization for Economic Cooperation and Development (OECD) in its Principles for Corporate Governance issued in 1999 and revised in 2003. These principles consolidate the best practices guidelines for corporate governance applicable to issuers into distinct concepts, namely:

- Rights of investors;
- Principles for the fair treatment of investors;
- Rights of third parties with interests in the issuer (stakeholders);
- Principles for disclosure of information and transparency; and
- Principles on the accountability of the board of directors.

Likewise, the so-called White Paper on Corporate Governance for Latin America, prepared by the OECD, contains specific recommendations for the region regarding the matters referred to in the Principles of the OECD for Corporate Governance. In Colombia, most of the standards enunciated by the Principles of the OECD and the White Paper on Corporate Governance for Latin America are generally contained in the Code of Commerce applicable to a wide variety of corporate entities. However, this chapter only addresses corporate governance standards applicable to issuers. These standards include:

- Rules applicable to boards of directors;
- Rules on audit committees; and
- The *Código País*.

Boards of Directors. Law Number 964 of 2005 requires that the board of directors of issuers must consist of at least five and no more than 10 members, of whom at least 25 per cent should be independent, as well as their respective alternates. Moreover, the issuer's legal representative cannot serve as chairman of the board of directors.

Audit Committees. Pursuant to Law Number 964 of 2005, the board of directors of an issuer must include an audit committee. In essence, the audit committee's responsibilities include the oversight of the preparation, presentation, and disclosure of financial statements and ensuring compliance with applicable laws. Although the responsibilities of the audit committee must be set forth in the bylaws of the issuer, by applicable law, audit committees must comply with the following requirements:

- The audit committee must consist of at least three independent members of the board of directors. Furthermore, the audit committee must have the presence of the issuer's fiscal auditor, who cannot vote on any matters put before the audit committee but who serves in an advisory capacity to the committee;

- The committee's decisions must be taken by simple majority;
- Prior to submission of the issuer's financial statements to the board of directors or at the general shareholders meeting, the committee must review and analyze the issuer's financial statements to ensure their veracity and compliance with applicable accounting and auditing rules; and
- The committee must meet at least every three months, and its decisions must be recorded in writing.

In addition, Law Number 964 of 2005 provides for additional mandatory corporate governance standards specifically for issuers that are companies with shares or bonds convertible into shares registered with the RNVE. The additional requirements applicable to these issuers include:

- Protections for initiatives proposed by minority shareholders;
- Disclosure of shareholder agreements;
- Special stock repurchase procedures; and
- Special share issuance and placement rules.

Código País. In 2007, the Superintendence issued Circulars 056 and 028 to promulgate a model code of corporate governance for issuers (*Código País*). The *Código País* contains provisions covering the following matters:

- Rights and equal treatment for all shareholders;
- Participation by minority shareholders in shareholder meetings;
- Additional committees to support the board (ie, corporate governance committee);
- Related-party transactions; and
- Dispute resolution mechanisms.

Even though the provisions contained in the *Código País* are of voluntary adoption, issuers are required to report annually to the Superintendence on their compliance with the provisions contained in the model code. The Superintendence established in Circular 007 of 2011 that the *Código País* is based on the 'comply or-explain' approach and, therefore, issuers that do not comply with any of the provisions contained in the *Código País* are required to explain their reasons for non-compliance.

Trading of Securities in Stock Market — Secondary Market

In General

The secondary market consists of the securities traded between investors, in which either a purchaser or a seller may initiate the transactions. Generally, the

purchase or sale of securities in the secondary market may be undertaken without prior authorization of the Superintendence. Secondary market securities transactions may be performed on the over-the-counter (over-the-counter) market or through trading systems.

In addition, Colombian regulations provide that, with some specific exceptions, any transaction involving listed shares that represent an amount equal to or greater than the equivalent in Colombian Pesos of 66,000 UVR (*Unidades de Valor Real*), approximately COP $14,080,000 in 2014, must be made through a stock exchange. Pursuant to Decree Number 2555 of 2010, the following are exceptions to undertaking transactions through a stock exchange:

- Transactions executed between a same beneficial owner;
- The sale or purchase of shares owned by financial institutions subject to a liquidation proceeding;
- Repurchase of shares;
- Transactions carried out abroad for securities being publicly offered in a foreign country; or
- Transactions carried out abroad for securities being publicly offered in Colombia.

The Superintendence may approve any other transaction to be carried out without using a stock exchange's trading system. Even though purchases or sales of securities on the secondary market are generally not subject to prior authorization by the Superintendence, there are certain situations when the trading of securities must be made through a public tender offer, which requires authorization from the Superintendence. Likewise, authorization from the Superintendence is required to carry out trades for securities pursuant to either public procedures, or public auctions and democratization public offers.

Public Tender Offers

Pursuant to Decree Number 2555 of 2010, any person or group of persons willing to acquire or become the beneficial owner(s) of 25 per cent or more of the shares of a listed company or being already the beneficial owner(s) of 25 per cent of the shares of a listed company, intending to increase participation by more than five per cent, must launch a public tender offer (*oferta pública de adquisición*, OPA). An OPA in the Colombian market must be addressed to all the shareholders of the relevant company and constitute an offer to acquire at least five per cent of the total outstanding shares of the company.

When a beneficial owner of more than 25 per cent of the shares of a listed company has privately acquired less than five percent (5 per cent) of the total shares outstanding, such person or group of persons must launch an OPA at the moment that such private transactions add up to reach the five per cent

threshold. Notwithstanding the above, the obligation to launch an OPA will not apply when:

- There is unanimous written consent of the voting shareholders of the target company expressing their agreement to conduct all transactions privately;
- The shares are acquired through a privatization process;
- The company is repurchasing its own shares;
- The company issues new capital;
- The company is conducting debt-for-equity swaps; and
- The person or group of persons becomes the beneficial owner of the shares by means of a: (a) donation; (b) succession; (c) court order; (d) company liquidation; (e) liquidation of marital property; or (f) payment in kind (*Dación en pago*).

In addition, the notion of 'beneficial owner' is defined in Decree Number 2555 of 2010 as any person or group of persons that, directly or indirectly, due to a contract or any other legal act, has or may have influence to affect the decisions of a company and has capacity to sell the respective shares. Companies and their subsidiaries are considered ultimate beneficiaries, as well as married couples and relatives upon second grade of blood relation.

Public Auctions

The public auction (*martillo*) is a public process for the purchase of securities initiated by a seller, which takes place through the BVC. A public auction for securities of an issuer requires prior authorization from the Superintendence of Industry and Trade if required by the competition regulations. To carry out a public auction, the sellers must present a written request to the BVC for the transfer of securities to be put up for public auction, which has 10 days to accept or reject the request for a public auction.

If the BVC accepts the proposal for a public auction, the BVC must inform the member brokers within two days of its acceptance, and request authorization from the Superintendence to carry out the public auction. The Superintendence has five business days to respond to the BVC's request for authorization of the public offer. If the Superintendence authorizes the holding of a public auction, the sales prospectus of the public auction must be presented to the BVC at least 10 business days prior to the date of publication of the first notice of the public auction. The sales prospectus also must be submitted for comment to the Superintendence at least five days prior to the publication of the first notice.

Once the BVC approves the content of the sales prospectus and if there are no objections from the Superintendence, three consecutive notices, issued at minimum intervals of five business days, must be published to announce the public auction in a nationwide newspaper and in the daily bulletin of the BVC.

The president of the public auction must present the notice proposal to the Superintendence, which must provide any comments it may have within five business days from the date of receipt of such notice proposal.

Once the Superintendence issues its authorization, the sales prospectus for the public auction must be presented to the BVC, at least 10 business days prior to the date of publication of the first notice. The sales prospectus also must be submitted to the Superintendence at least five business days prior to the publication date of the first notice. The trading of securities subject to the public auction will be suspended as of the date when the notice is presented to the Superintendence until the day following the first publication. The seller must deposit the securities to be auctioned with the BVC, for subsequent transfer to any winning bidders, no later than the date of publication of the third and final notice to announce the public auction.

Once the three notices have been circulated, the interested bidders must submit guarantees of their position to support their prospective bid to the BVC no later than one business day prior to the day of the auction. The admissible guarantees to participate in public auctions are similar to those required to participate as bidder in a public tender offer of shares. Once these requirements have been met, the public auction may be held at the BVC, and upon completion of the public auction, the necessary payments may be made, as well as DECEVAL registration of the new owner or owners of the auctioned securities.

Democratization Offers

The democratization offers are those in which the controlling shareholder of an issuer offers, under conditions that allow for broad participation, part or all of the securities it owns, using procedures for the sale that guarantee wide publicity and free attendance, such as advertising campaigns through the media. For the democratization offer to be effective, it is necessary that the securities offered be:

- Registered with the BVC at least six months prior to the date of the operation; and
- Not subject to any liens or encumbrances, including tax liens, domain constraints, or any pending lawsuits or claims that may affect the property or its trading.

To carry out democratization offers, there must be a request authorization from the Superintendence to carry out the offer. The Superintendence has five business days, as of the first business day following the date when the request is presented, to make the observations it deems pertinent. The term during which the offer must remain in force may not exceed three months. Having met the above requirements, the transfer of securities may be done by means of the regular trading rounds of the BVC, or by means of special trading rounds authorized by the Superintendence.

Pooled Funds and Private Equity

Pooled Funds. The formation and management of pooled funds is subject to Decree Number 2555 of 2010, which defines pooled funds (*fondos de inversion colectiva*) as financial vehicles created for raising capital from third parties. These vehicles are formed with input from a plurality of the participating investors. The capital raised is managed professionally to achieve collective economic results.

Pooled funds are subject to supervision by the Superintendence. Decree Number 2555 establishes two kinds of pooled funds—open pooled funds, in which the equity interests may be redeemed before the expiration of the fund's term, and closed pooled funds, which means that equity interests may only be redeemed upon expiration of the fund's term unless partial and advanced redemptions are required by law, or the fund is required to distribute the appreciated value of equity interests. However, it is feasible to structure staggered pooled funds in which the placement rules of the fund establish different terms for the redemption of the equity interests over the life of the fund.

Private Equity. Pursuant to Decree Number 2555, private equity funds are defined as *Fondos de Capital Privado*, FCPs), which are closed pooled funds (*fondos de inversión colectiva cerradas*) in which at least two-thirds of the capital contributions are invested in assets other than publicly traded securities registered with the National Registry of Securities and Issuers (*Registro Nacional de Valores y Emisores*, RNVE).

An FCP is a special-purpose vehicle that is not considered a separate legal entity. As such, an FCP must be administrated by an authorized company such as a fiduciary entity (*sociedad fiduciaria*), a brokerage firm (*sociedad comisionista de bolsa*), or an investment management corporation (*sociedad administradora de inversión*). Such companies are generally referred to as 'Management Companies', and they are responsible for the general administration of the FCP.

In addition, Decree Number 2555 establishes that FCPs must be managed by either a professional manager or general partner (*gestor profesional*, GP) designated or hired by the Management Company. The GP must be an expert in the management of investment portfolios or the types of assets in which the fund aims to invest, and must have at least five years of relevant experience. The GP makes the investment decisions and is responsible for the formulation of the FCP's overall investment strategy.

Any locally incorporated FCP must have a minimum of two investors, each with a contribution of at least US $194,526.[9] FCPs are subject to administrative regulations issued by the Colombian Central Bank with respect to currency and

9 Calculated using an exchange rate of COP $1,900 per US $1.

foreign exchange matters, as well as administrative and technical regulations issued by specific supervisory governmental agencies, particularly the Superintendence. The Superintendence's regulations address specific issues for FCPs, such as fund formation monitoring, fund portfolio and individual equity valuation methodologies and reporting standards, management, compliance issues, and profitability disclosure rules.

Approaches to Jurisdictional Conflicts

Conflict of Laws

The Constitutional Court has established that, in Colombia, conflict of laws rules are included in articles 18, 19, 20, and 21 of the Civil Code and article 38 of Law Number 153 of 1887.[10] Based on the criteria of residence, article 18 states the unconditional principle of territoriality of Colombian law as mandatory for citizens and foreigners.

Based on the criteria of nationality, article 19 states the principle of extraterritoriality of Colombian law, in relation to Colombian residents or Colombians domiciled abroad, regarding civil status, capacity to undertake certain acts that have effect in Colombia, and obligations and rights derived from domestic relations.

Based on the criteria of the place of location (*lex rei sitae*), paragraph 1 of article 20 establishes the unconditional principle of territoriality of Colombian law in connection with movable goods and real property, owned by citizens or foreigners and affairs over which the country has interest or right.

Based on the criteria of the place of execution of the contracts (*lex loci contractus*), paragraph 2° of article 20 authorizes the application of a foreign law to contracts validly executed abroad, provided that they do not relate to goods or assets located in Colombia.

Based on the criteria of the place of performance of the contracts (*lex loci solutionis*), paragraph 3° of article 20 states that if the contract must be complied with in Colombian territory or generates effects inherent to the rights or interests of the country, Colombian law must be applied.

Based on the principle of the place of signature (*locus regit actum*), article 21 of the Civil Code and article 38 of Law Number 153 of 1887 remit the solution of the merits regarding the form of the public deeds to the laws of the country in which these have been granted.

The Colombian legal system adopts the mandatory principle of international private law of *lex loci solutionis*, in which the applicable law to any contract is the law of the place of its performance, regardless of the choice of law and

10 Constitutional Court. Judgment C-249 of 2004 of 16 March 2004.

forum selection included in the contract. Article 869 of the Commercial Code is deemed as a public policy rule and, as such, its observance is mandatory.

The Civil Chamber of the Supreme Court of Justice has held that under principles of private international law, the manner in which the obligations are extinguished must be governed by the law of the place set forth by the compliance of such obligations. In this regard, the *lex loci solutionis* becomes applicable to any case related to the form in which the payment must be made, the goods that must be paid for, and the people to whom such payment can be made.

Notwithstanding the above, the *lex loci* solution also is has been interpreted in the sense that, if a substantial portion of the obligations derived from an agreement to be entered into by a Colombian resident is performed outside Colombia, Colombian courts would uphold as valid the choice of a foreign law. Due to reciprocity and territoriality principles, it must be concluded that, as with the application of Colombian law being mandatory in the performance of contracts that were executed abroad, it must be acceptable that the compliance with obligations in other countries is governed by the legal systems of such countries, regardless of the fact that the obligations derive from agreements executed in Colombia.

The Civil Procedure Code provides that the courts sitting at the place of domicile of the defendant or the place where the contract at issue was performed will decide disputes arising out of contracts. As a result, a choice of forum provision whereby the parties agree to submit their disputes to a specific court would be considered null and void. Notwithstanding the above, if the contract is performed outside Colombia, foreign courts may have jurisdiction. Although parties may not agree to submit the dispute to a specific court, they are entitled to submit their disputes to international arbitration. Pursuant to Law Number 1563 of 2012, parties may agree to submit their disputes to international arbitration when:

- The parties have their domiciles in different states;
- A substantial part of the obligations will be performed outside of the state in which the parties have their principal domicile; and
- The dispute relates to international commerce interests.

In this event, the parties may agree upon the procedural rules or to submit the dispute to an arbitration center such as the International Chamber of Commerce, the American Arbitration Association, or the London Court of International Arbitration. The parties to such an agreement also may decide the substantive law applicable to the dispute, language, number of arbitrators, and seat of the arbitration.

Colombia is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, the enforcement of awards handed down by international arbitration panels requires the completion of

exequatur proceedings before the Colombian Supreme Court of Justice, in accordance with article 695 of the Code of Civil Procedure (which will be abrogated by article 607 subject to the entry into force of Law Number 1564 of 2012 (*Código General del Proceso*) pursuant to the terms of article 627, paragraph 6).

Pursuant to articles 693 and 694 of the Code of Civil Procedure (which will be abrogated by articles 605 and 606 subject to the entry into force of Law Number 1564 of 2012 (*Código General del Proceso*) pursuant to the terms of article 627, paragraph 6), the courts of Colombia will give effect to and enforce a judgment obtained in a court outside Colombia without re-trial or re-examination of the merits of the case if there is a treaty or convention relating to recognition and enforcement of foreign judgments between Colombia and the country of origin of the judgment.

In the absence of such treaty, proper evidence must be provided to the Supreme Court of Justice to the effect that the courts of the country of the subject judgment would recognize and enforce Colombian judgments and the foreign judgment fulfills the following requirements:

- The judgment does not refer to *in rem* rights over assets located in Colombia as of the date of filing of the proceedings;
- The judgment is not contrary to Colombian public policy (mandatory) provisions, except for rules of procedure;
- The judgment is final and executory in accordance with the laws of the country of origin, and a duly authenticated and legalized copy is filed with the plaintiff's request for exequatur (article 605 of Law Number 1564 of 2012 only requires a legalized copy of the foreign judgment);
- The matter of the judgment is not subject to the exclusive jurisdiction of the courts of Colombia;
- There are no ongoing proceedings in Colombia or any final judgment rendered by Colombian courts in connection with the same subject matter; and
- If the judgment has been rendered in a contentious matter, the requirements of due service of process to the defendant was complied with in accordance with the laws of the country of origin.

Cyprus

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Cyprus

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Introduction

In General

The modern era for the securities sector in Cyprus began in 1996 with the inauguration of the Cyprus Stock Exchange (CSE), the first official stock exchange in Cyprus.

The CSE is modeled on current international securities rules and practices and aspires to consolidate the position of Cyprus as a regional business and financial services centre and boost the growth of capital markets in Cyprus.

Sources of Law

The principal legislation governing the issue and trade of securities in Cyprus is as follows:

- Securities and Stock Exchange Law, 14(I) of 1993, as amended;[1]
- Securities and Stock Exchange Regulations of 1995–2005 (Part 1);[2]
- Securities and Stock Exchange Regulations of 1995-2005 (Part 2—Supplements);
- Trading Rules (Regulatory Administrative Act) 409/2006, as amended;[3]

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1 Laws 32(I) of 1993, 91(I) of 1994, 45(I) of 1995, 74(I) of 1995, 50(I) of 1996, 16(I) of 1997, 62(I) of 1997, 71(I) of 1997, 83(I) of 1997, 29(I) of 1998, 137(I) of 1999, 19(I) of 2000, 20(I) of 2000, 39(I) of 2000, 42(I) of 2000, 49(I) of 2000, 50(I) of 2000, 136(I) of 2000, 137(I) of 2000, 141(I) of 2000, 142(I) of 2000, 175(I) of 2000, 9(I) of 2001, 37(I) of 2001, 43(I) of 2001, 66(I) of 2001, 79(I) of 2001, 80(I) of 2001, 81(I) of 2001, 82(I) of 2001, 105(I) of 2001, 119(I) of 2001, 120(I) of 2001, 1(I) of 2002, 87(I) of 2002, 147(I) of 2002, 162(I) of 2002, 184(I) of 2003, 164(I) of 2004, 205(I) of 2004, 43(I) of 2005, 99(I) of 2005, 115(I) of 2005, 93(I) of 2006, 28(I) of 2007, 56(I) of 2009, 90(I) of 2009, and 171(I)/2012.

2 Regulations 214 of 1995, 342 of 1997, 268 of 2000, 361 of 2000, 59 of 2001, 139 of 2001, 329 of 2001, 141 of 2002, 306 of 2002, 368 of 2002, 614 of 2003, 579 of 2004, and 559 of 2005.

3 Rules 409 of 2006, 228 of 2007, 598 of 2007, 107 of 2008, 193 of 2008, 221 of 2008, 357 of 2008, 396 of 2008, 484 of 2008, 48 of 2009, 100 of 2009, 172 of 2009, 234 of

- Regulatory Administrative Act 209/2011, as amended;[4]
- Securities and Stock Exchange (Central Securities Depository and Central Registry) Laws of 1996–2006;[5]
- Securities and Stock Exchange (Registering, Trading, and Settlement of Dematerialised Securities) Regulations 161/2001, as amended;[6]
- Regulatory Administrative Act 81/2005, as amended, relating to members of the Cyprus Stock Exchange;
- Regulatory Administrative Act 166/2005, as amended, relating to the Cyprus Stock Exchange Code of Conduct;[7]
- Regulatory Administrative Act 596/2005, as amended, relating to the listing of securities on the Cyprus Stock Exchange, continuous obligations of issuers, and fees; and
- Regulatory Administrative Act 398/2006, as amended, relating to the operation of the Central Registry and Central Depository.[8]

Regulatory Authorities

The CSE was established under the Securities and Stock Exchange Law in April 1993. A seven-member Council (CSE Council) is responsible for the day-to-day management of the CSE and the implementation of its policies.

The CSE is supervised by the Cyprus Securities and Exchange Commission (CySEC), which comprises a government commissioner, a representative of the Central Bank, and three other members appointed by the Council of Ministers.

The regulatory regime aims to balance the interests of issuers and investors, by providing proper protection to local and foreign investors, without making it unduly onerous for companies to obtain and maintain a listing on the CSE.

Admission to Cyprus Stock Exchange

The CSE is the only official investment exchange in Cyprus. The roots of the CSE date to 1979 when the Cyprus Chamber of Commerce and Industry established an unofficial over-the-counter exchange to regulate the growing

2009, 346 of 2009, 380 of 2009, 215 of 2011, 366 of 2011, 38 of 2012, 181 of 2012, 189 of 2012, 350 of 2012, and 419 of 2013.

4 Rule 508 of 2012 and 421 of 2013.

5 Laws 27(I) of 1996, 62(I) of 2001, 121(I) of 2001, 136(I) of 2002, 43(I) of 2003, 8(I) of 2005, 92(I) of 2006, 100(I) of 2008, 55(I) of 2009, 91(I) of 2009, 100(I) of 2010, and 133(I) of 2011.

6 Regulations 161 of 2001, 367 of 2002, 393 of 2003, and 123 of 2005.

7 Rule 526 of 2005.

8 Rules 446 of 2006, 22 of 2007, 170 of 2007, 552 of 2007, 604 of 2007, 64 of 2008, 340 of 2008, 21 of 2009, 102 of 2009, 255 of 2010, 317 of 2010, 363 of 2010, 507 of 2012, 48 of 2013, 179 of 2013, and 423 of 2013.

securities market. As a result, a dynamic market had developed by the time the CSE opened its doors.

Market Participants

Only members of the CSE holding the requisite licence from the CSE Council may exercise the profession of stockbroker. The licence is readily granted if the broker satisfies a set of prerequisites relating to educational qualifications, professional experience, and personal and financial integrity.

Types of Traded Securities

Under the Securities and Stock Exchange Law, listed public sector securities, corporate securities of listed companies, and other securities which the CSE Council has declared as Stock Exchange securities can be traded on the CSE. These securities include shares, rights, warrants, corporate bonds, government bonds, and treasury bills.

Types of Transactions

The CSE boasts advanced technology comparable with that of established overseas exchanges. Its fully automated computerised trading system (consisting of the Central Registry Depository and Clearing & Settlement System) became fully operational on 7 May 1999 under section 22 of the Securities and Stock Exchange Law and regulation 33 of the Securities and Stock Exchange Regulations.

Opening Trading Account

All securities traded under the Central Registry Depository and Clearing & Settlement System are in dematerialised form with transfers effected through a central electronic book entry system maintained at the CSE. Investors who wish to execute stock exchange transactions can do so only if they have trading accounts. There are two types of trading accounts, namely:

- A general trading account where an investor gives discretion to a member of the CSE to effect stock exchange transactions in relation to listed securities; in particular, the member is given the right to sell any security which the investor has or will have transferred to the general trading account, as well as the right to buy any security; and
- A special trading account where the investor gives discretion to a member of the CSE to purchase (but not to sell) securities which will be transferred to the depository account of the investor as soon as they are acquired; the member is not given access to those securities and does not have the discretion to sell them.

Generally, an investor can open a number of trading accounts with various brokers and for a number of different purposes including for ‘buy only’ or ‘buy/sell’ trades.

General or special trading accounts are easily opened using the prescribed form of application, namely, Form 10A for a general trading account and Form 11 for a special trading account.

A prerequisite to the opening of a trading account is the opening by the investor of a depository account, irrespective of whether or not there are any securities in the depository account. A depository account is the account in which all the dematerialised securities which an investor holds at the CSE Central Registry are recorded. A person wishing to acquire listed securities for the first time must open a depository account by application to the CSE using prescribed Form 1.

Central Registry and Depository and Settlement System

The Securities and Stock Exchange (Central Securities Depository and Central Registry) Law, 27(I) of 1996, provides for the establishment and operation of a central register for all securities listed on the Cyprus Stock Exchange, the dematerialisation of these securities, the settlement of transactions in respect of dematerialised securities, and related matters.

The Central Registry and Depository contains personal information on individual investors, details of the securities owned by them, and any changes in their shareholdings. More specifically, the Central Depository and Securities Register entails the replacement of share certificates by electronic computer records. Instead of certificates of securities, beneficiaries of registered securities are granted a certification of their status, the securities involved, and any charges they carry.

The Settlement System is the part of the Cyprus Securities Depository by which trades and transactions due for settlement are processed within the CSE. The Settlement System deals with the securities side of settlement at the individual investor level as well as the funds side of settlement at the market participant level (brokerage firms).

Security positions occur automatically within the system on the settlement date, while the settlement of cash positions between market participants and the clearing house occurs on the settlement date through the banking system. The system supports delivery versus payment settlement. There are two settlement methods which are utilised and which have as their intention the reduction of settlement risk and the enhancement of investor confidence and volume of trading. These are as follows:

- Contractual Netting Settlement — where cash is netted by a market participant who is either a net buyer or a net seller; and
- Trade-for-Trade Settlement — where each trade is settled for cash separately with no netting.

Over-the-Counter Transactions

As a general rule, the Securities and Stock Exchange Law prohibits over-the-counter trading of securities. However, certain transactions set out in section

23(1) of the Securities and Stock Exchange Law may be executed outside the CSE provided that they are notified to the CSE within three working days. To transfer securities in accordance with the Stock Exchange laws and regulations, the following must be delivered to the CSE:

- A transfer document in the prescribed form (Form 2), signed by both the transferor and the transferee;
- A form for notification of practices involving listed securities (Form 3); and
- Transaction fees payable to the CSE[9] in accordance with the Fees for Stock Exchange Transactions, Law Number 161(1) of 1999, as amended.[10]

Issuer Requirements

In General

An issuer (whether local or foreign) seeking a listing on the CSE must satisfy certain basic requirements which vary according to the market on which it intends to list its securities. These are as follows:

- The issuer must have been duly incorporated and must operate in accordance with the laws of its jurisdiction of incorporation;
- The laws of the jurisdiction of incorporation of the issuer and its constitutional documents must allow the issuer to issue the specific securities intended to be listed;
- The listing must be in respect of securities issued or proposed to be issued of the same category;
- The issuer must ensure that existing shareholders have the opportunity to take advantage of pre-emptive rights in subsequent share issues;
- The listing must relate to fully paid securities;
- The issuer must prove (to the CSE Council) that it has sufficient working capital at its disposal;
- The issuer must comply with all statutory reporting and disclosure requirements under the scrutiny of the CSE Council;
- The issuer must be in a position to deliver its register in electronic form to the Central Securities Depository and Central Registry;
- In the case of a financial services firm the application must be related to the financial services firms market;
- The issuer must provide guarantees for the protection of investors; and

9 The seller of the securities or the person notifying the sale to the Stock Exchange, as the case may be, is the party responsible for the payment of the relevant transaction fees to the Stock Exchange.

10 Laws 167(I) of 2001, 28(I) of 2002, 92(I) of 2002, 231(I) of 2002, 187(I) of 2003, 60(I) of 2005, 150(I) of 2005, 192(I) of 2007, 142(I) of 2009, 177(I) of 2011, and 87(I)/2012.

- The issuer must not undertake any obligations inconsistent with the interests of its other shareholders.

In 2008, with the implementation of the Common Trading Platform between the CSE and the Athens Stock Exchange, the market of listed companies was completely overhauled through the creation of a number of specialised markets, making the market provided by the CSE more flexible and bringing it into line with its international counterparts.

The new markets are the Main Market, Parallel Market, Alternative Market, Investment Firms' Market, Major Projects Market, Shipping Companies Market, Special Category Market, Corporate Bonds Market, and the Undertakings of Collective Investments in Transferable Securities (UCITS) Market. In late 2009, the CSE introduced an Emerging Companies Market in the form of a multilateral trading facility as defined in Council Directive 2004/39/EC.

Prospectus Requirements

Requirements under Securities and Stock Exchange Law and Regulations

The prospectus and listing particulars requirements imposed on issuers seeking a listing on the CSE closely follow the principal body of EU Directives and Regulations in this area. Prospective issuers may list their securities on the CSE by one of the following methods:

- Public offer for subscription for the purchase of shares which have not yet been issued or allotted;
- Public offer for sale of shares which have already been issued or allotted;
- Offer for sale through the introduction of shares already issued or allotted; and
- Private placement, through marketing exclusively to specific investors for the sale of shares which have already been issued or are about to be issued.

To apply for a listing, a company must submit to the Council of the CSE a signed application and a number of other supporting documents, including a suitability questionnaire, a corporate profile and, most importantly, the listing particulars which vary according to the market on which the relevant securities are proposed to be listed.

Aside from serving disclosure and screening purposes, the listing requirements are designed to help investors evaluate the assets and liabilities, financial position, and the prospects of the issuer and of the rights attaching to the securities to be listed.

In the case of initial public offerings, the level of information required for the preparation of the listing particulars is substantial: for subsequent issues these requirements are less stringent. Furthermore, the CSE Council has the discretion to wholly or partially exempt an issuer from the obligation to prepare listing particulars, under the conditions outlined in Regulatory Administrative Act 596/2005.

The degree of disclosure also varies according to the status of the issuer (general corporate issuer, an investment company, or the government), the type of placement (private or public), and the type of securities proposed to be offered (shares, rights, warrants, or bonds).

Requirements under Companies Law

The Companies Law also lays down certain prospectus requirements with regard to public issues of securities. Following the enactment of Law 99(I) of 2009, the prospectus requirements set out in sections 37–46 of the Companies Law do not apply in relation to shares or debentures to which the Public Offer and Prospectus Law[11] or the UCITS Law[12] apply.

Section 2(1) of the Companies Law defines a prospectus as any prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase of any shares or debentures of a company. The main requirements can be found in the prospectus and allotment provisions and in the Third, Fourth, and Fifth Schedules to the Companies Law.

The prospectus provisions of the Companies Law are mainly concerned with invitations to the public to acquire shares or debentures. The definition of a public offer given in section 54 is very broad and encompasses any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner. This formula is not only wide but also flexible, enabling the courts to deal with each case on its own merits and in accordance with its specific circumstances. As a result, companies must comply with the prospectus requirements of the Companies Law not only in cases of direct offers for subscription or rights and conversion issues but also whenever they publish a document of any kind to the effect that they allot or agree to allot any securities with a view to their being offered for sale to the public. Therefore, the latter provision also covers offers for sale and placements unless they are of a purely domestic nature and do not involve either renounceable allotment letters or a stock exchange introduction.

The Companies Law provides that a copy of the prospectus signed by the directors must be filed with the Registrar of Companies before its issue, which must contain specific information as set out in the Fourth Schedule to the Companies Law. An abridged prospectus which does not need to comply with the requirements of section 39 and the Fourth Schedule to the Companies Law is admitted whenever shares or debentures are in all respects uniform with those already issued and quoted on a prescribed stock exchange.[13]

11 Law 114(I) of 2005, as amended.
12 Law 200(I) of 2004, as amended.
13 Companies Law, s 39(5)(b).

If a public company, on its formation or after its conversion from a private company, does not publish a prospectus or subsequent to publication does not proceed with the allotment of its securities, it is obliged to file a statement in lieu of a prospectus with the Registrar of Companies in accordance with sections 31 and 48 and the Third and Fifth Schedules to the Companies Law.

Registration of Public Offerings

When the issuer applies for the registration of a public offer for subscription for the purchase of shares which have not yet been issued or allotted, the issue must be underwritten by at least one underwriter, who may be a member of the CSE, a commercial bank, or other person approved by the CSE Council.

Public offerings are subject to full prospectus requirements to enable potential investors to make informed investment decisions based on publicly available and readily accessible information.

To be able to publish a prospectus for the introduction of shares on the CSE, the prospective issuer requires a licence from the CSE Council which, once obtained, obliges the issuer to publish the listing particulars within 15 days in at least two daily national newspapers. The prospectus also must be made available at an address in Cyprus where interested parties can obtain a copy of it.

Within 48 hours of publication, the issuer must deposit with the CSE Council three copies of the newspapers. The final step is for the CSE Council officially to announce its decision to accept the listing of the shares and to fix a date for the commencement of trading.

Registration of Placements

According to the Prospectus Law, 114(I) of 2005, which implemented EU Directives 2001/34 and 2003/71, a 'public offer of securities' is defined as a communication to persons in any form and by any means by which sufficient information on the terms of the offer and the securities to be offered is provided so that a potential investor can decide whether or not to purchase those securities.

According to section 4(1) of the Prospectus Law, no offer of securities may be made without the publication of a prospectus which has been approved by CySEC. The publication of a prospectus under the provisions of the Prospectus Law applies to the placement of securities through market intermediaries, provided that such placement falls under the definition of a public offer.

The offers to which the Prospectus Law applies are determined by elimination of the relevant exemptions set out in the Law. An offer not falling within one of

the following exceptions should be categorised as a public offer to which the Prospectus Law should apply:

- Offers addressed solely to qualified or professional investors;
- Offers addressed to a limited number of persons (for the purposes of the Prospectus Law, such persons are confined to natural and legal persons not being qualified investors and not exceeding 100 in number);
- Offers addressed to investors who acquire securities for a consideration of at least €50,000 per investor for each separate offer;
- Offers whose denomination per unit is at least €50,000, provided that the same unit cannot be acquired by more than one investor; and
- Offers whose total consideration does not exceed a limit of €100,000 calculated over a period of 12 months.

Periodic Disclosure

Continuing Disclosure Obligations of Ordinary Corporate Issuers

Issuers of shares must comply with the continuing obligations set out in Regulatory Administrative Act 326/2009. The aim of placing issuers under ongoing scrutiny is to prevent the emergence of a false market where transactions in securities are effected on the basis of incorrect or outdated information. By the same token, periodic disclosure requirements protect investors by keeping them informed about the issuer's activities, current profits or losses, and future prospects.

Listed companies are under an obligation to publish half-yearly accounts, preliminary annual accounts, and annual accounts. Approved investment companies are subject to a stricter reporting regime which requires them to publish accounts on a quarterly basis in full compliance with international accounting standards.

Apart from making financial statements available to the public at large on the indicated dates, listed companies have an obligation to announce at least 10 days in advance the date on which the board of directors is to recommend payment or non-payment of a dividend, to approve financial statements, or to discuss any matter regarding the listed securities of the company concerned. In view of the sensitivity of the price of listed securities to corporate acts, companies must announce to the CSE immediately, and at least one hour before trading, decisions relating to certain matters such as new bond issues, changes to their capital structure, and amendments to their constitutive documents.

Under sections 120 and 121 of the Securities and Stock Exchange Law, any person failing to comply with the obligation to announce information in accordance with the provisions of the Securities and Stock Exchange Law or Regulations commits an offence punishable by the imposition of an administrative fine. In addition, the CSE Council may resolve to suspend the listing of the company concerned.

Exemption from Continuing Disclosure Duties

Under rule 5.2 of Regulatory Administrative Act 596/2005, the Council has the power to exempt issuers from continuing disclosure obligations as regards information which is deemed to be injurious to the issuer's interests as long as non-disclosure is not likely to adversely affect or mislead the investing public.

Disclosure Requirements under Companies Law

With the exception of share warrants, bearer shares or bearer instruments are not permitted under Cyprus law, giving investors valuable information about the status of their investments through the recording procedure for the transfer of securities and by inspection of the registers of securities.

This transparency of dealings in securities is embodied in the Companies Law,[14] in the relevant provisions of Part V of the Securities and Stock Exchange Law, and in Parts IV and V of the Securities and Stock Exchange Regulations.

Trading Rules and Trading Environment

Offerings of Securities

Once the CSE Council has approved the introduction of an issuer's securities in the market, they may be freely transferred from the current holder to any purchaser. Every transfer of listed securities through the CSE must be recorded on a transfer form.

The member of the CSE acting on instructions from the offeror (who need not necessarily be the issuer of the securities being offered) is responsible for presenting the form to the purchaser within the time limit prescribed by the Securities and Stock Exchange Regulations. Following settlement of the transaction, the member acting on instructions from the purchaser must ensure that the certificate of transfer is duly issued.

The transfer of ownership of dematerialised securities following the settlement of a transaction is effective from the time the transaction is registered on the Central Depository and Securities Register.

Rules Pertaining to Stock Exchange Transactions

Exchange transactions are executed and cleared in accordance with the provisions of the Securities and Stock Exchange Regulations. Transactions of registered securities are finalised with the issue of a certificate of transfer, which may only be issued on satisfaction of all of the following conditions:

- Deposit with the CSE of a duly executed transfer document signed by both the seller and the purchaser or their representatives;

14 Companies Law, ss 71–82 and 90–113.

- Completion of the relevant exchange transaction within the prescribed period;
- Deposit of the original share certificate (or ownership certificate) or a valid substitute for it; and
- Payment of the prescribed fees.

The certificate of transfer must bear the official seal of the CSE as evidence that the relevant transaction has been executed through it. Brokers must complete transactions during the period from the day of the execution of the transaction and the hour of the opening of market trading on the day which follows three working days during which the market is open for trading.

By 11 o'clock in the morning of the last working day of the time limit, the two brokers involved in the transaction must have reached the settlement stage of the transaction. This deadline is prescribed by the Securities and Stock Exchange Regulations and, therefore, purchaser and seller cannot agree otherwise.

As a general principle, settlement of transactions in securities through the Cyprus Stock Exchange operates on a delivery versus payment basis which also is implied in regulations 30(2), 41(1)(a), and 49(3) of the Securities and Exchange Regulations.

Regulatory Requirements Applicable to Stockbrokers

Firms acting as stockbrokers in CSE transactions are supervised by CySEC. In addition, CySEC has overall supervisory responsibility for the CSE on behalf of the Minister of Finance.

Subject to certain requirements, banks and insurance companies may be registered as stockbroker members with the CSE and obtain member status.[15] A foreign entity can be licensed as broker provided that it is established in accordance with the Companies Law. If a foreign entity wishes to undertake brokerage activities in Cyprus, it may register either a subsidiary company or a branch. In addition, foreign entities must comply with the necessary requirements of the Securities and Stock Exchange (Central Securities Depository and Central Registry) Law[16] by becoming a registered member of the CSE.

Regulatory Administrative Act 166/2005a sets statutory rules of conduct and duties for CSE members. A person who carries on the business of a broker without being registered as a member of the CSE commits an offence punishable with imprisonment, a fine, or both. The paramount duty of members is to serve the interests of their clients in good faith and in accordance with the existing laws and practice relating to the CSE.

15 Securities and Stock Exchange Law, s 31.
16 Law 27(I) of 1996, as amended (1996–2006).

The relevant committee of the CSE Council may impose an administrative fine on any member who breaches the statutory rules of conduct. In practice, disciplinary measures are most commonly imposed on stockbrokers because of repeated failure to complete a transaction within the prescribed time limit. Violations of the regulations governing the minimum paid-up capital or the required bank guarantee may lead to the suspension of the stockbroker's licence. More serious disciplinary offences are punishable by suspension from the CSE for up to 15 days or temporary or permanent removal from the register of members of the CSE.

A compensation fund to provide security for transactions on the CSE was set up by the Securities and Stock Exchange Law. The fund assists in cases where a member faces financial difficulties in meeting obligations to principals or third parties. All members of the CSE are required to contribute to the fund.

Capital Markets and Financial Services

Sources of Law

The principal legislation governing this area comprises:

- Cyprus Securities and Exchange Commission Law, 73(I) of 2009, as amended by Law 5(I) of 2012 and Law 65(I) of 2014;
- Insider Dealing and Market Manipulation (Market Abuse) Law, 116(I) of 2005, as amended by Law 191(I) of 2007, Law 142(I) of 2012 and Law 61(I) of 2013;
- Transparency Requirements Law, 190(I) of 2007, as amended by Law 72(I) of 2009, Law 143(I) of 2012, and Law 60(I) of 2013;
- Investment Services and Activities and Regulated Markets Law, 144(I) of 2007, as amended by Law 106(I) of 2009, Law 141(I) of 2012 and Law 154(I) of 2012;
- Takeover Bids Law, 41(I) of 2007, as amended by Law 47(I) of 2009;
- Public Offer and Prospectus Law, 114(I) of 2005, as amended by Law 144(I) of 2012 and Law 63(I) of 2013;
- Open-ended Undertakings of Collective Investments in Transferable Securities Law, 78(I) of 2012;
- International Collective Investment Schemes Law, 47(I) of 1999, as amended by Law 63(I) of 2000; and
- Alternative Investment Fund Managers Law, 56(I) of 2013.

Cyprus Securities and Exchange Commission

CySEC is responsible for the supervision of the capital market, securing its smooth operation and methodical development and monitoring transactions in transferable securities taking place in Cyprus, in accordance with the provisions of the Cyprus Securities and Exchange Commission Law of 2009.

Insider Dealing and Market Manipulation (Market Abuse) Law

In General

Matters concerning the possessors of confidential information relating to financial instruments which are admitted for trading in a regulated market within Cyprus or in relation to which admission to trading has been requested from Cyprus are regulated by the Insider Dealing and Market Manipulation (Market Abuse) Law, 116(I) of 2005, as amended (the 'Market Abuse Law'). The Market Abuse Law, which transposed EU Directives 2003/6/EC, 2003/124/EC, 2003/125/EC, and 2004/72/EC, applies irrespective of whether or not the transaction itself is actually concluded in Cyprus. In 2005, CySEC issued a number of directives defining acceptable market practices:

- Directive 1-2005 regarding obligations of issuers of financial instruments;
- Directive 2-2005 regarding elements to be considered;
- Directive 3-2005 regarding market abuse methods;
- Directive 4-2005 regarding accepted market practices;
- Directive 5-2005 regarding code of conduct of directors and related persons; and
- Directive 6-2005 regarding notification of persons having managerial responsibilities for transactions.

Amendments to Market Abuse Law

In 2007, the Insider Dealing and Market Manipulation (Market Abuse) (Amendment) Law, 191(I) of 2007, amended the provisions of the Market Abuse Law relating to:

- The definition of a transaction;
- The scope of the Market Abuse Law;
- The public announcement of a transaction; and
- CySEC's cooperation and relations with its counterparts in other countries.

The amended definition of a transaction for the purposes of the Market Abuse Law includes a sale or acquisition and an agreement to sell or acquire financial instruments through an issuer, as well as the provision, acceptance, acquisition, disposal, and exercise of warrants or any other rights or obligations with the intention to acquire or dispose of a financial instrument or any other interest in a financial instrument through an issuer.

The second amendment made clear that the Market Abuse Law applies only to financial instruments that are listed on, or in respect of which an application for listing has been made to, a regulated market within Cyprus. Financial instruments listed on a regulated market outside Cyprus or in respect of which an application for listing has been made to such a market are excluded from its scope.

The third of the amendments requires persons holding a managerial position in an issuer, persons connected with it, and significant shareholders (those who directly or indirectly control five per cent or more of the issuer's shares, or five per cent or more of the voting rights attached to such shares) to disclose publicly their transactions connected with the issuer's financial instruments. Shareholders are now required to make a public announcement in relation to any transaction undertaken on their own account in connection with the issuer's financial instruments.

The final amendment requires CySEC to co-operate with the relevant authorities of other countries as well as with other organisations having the same or similar responsibilities, which include the monitoring of issuers and related persons to ensure their compliance with the relevant provisions of the Market Abuse Law, cooperation with other supervisory authorities, and the imposition of administrative sanctions. In furtherance of its duties, CySEC has the power to suspend trading of affected financial instruments, to freeze assets, and to suspend market participants' activities.

In 2012, the Insider Dealing and Market Manipulation (Market Abuse) (Amendment) Law of 2012, L. 142(I) of 2012, further amended the Market Abuse Law in order to transpose EU Directive 2010/78/EC into Cyprus law. The main change made by the amending law concerns the requirement for CySEC to cooperate with the European Securities and Markets Authority.

The Insider Dealing and Market Manipulation (Market Abuse) (Amendment) Law of 2013, L. 61(I) of 2013, further amended the Market Abuse Law in order to fully transpose Article 1, paragraph 2 of EU Directive 2004/72/EC into Cyprus law. The main change made by the amending law concerns the deletion and substitution of the Annex to the principal law by a new Annex concerning the interpretation of "close association" of one person with another person discharging managerial responsibilities within an issuer, and the amendment to the thresholds regarding publication of notice as set out in section 18 of the principal law.

Penalties for Non-Compliance

Breaches of the Market Abuse Law are punishable by administrative fines imposed by CySEC. Certain breaches also may result in criminal penalties. In addition to these sanctions, which are outlined below, the breach also may result in civil liability to compensate those who have suffered damage or loss of profit or both as a result of the act or omission concerned.

Insider Trading

Persons in possession of inside information, whether directly or indirectly, are prohibited from exploiting that information by acquiring or disposing of, or by trying to acquire or dispose of, for their own account or for the account of third parties, or through persons closely associated with them, financial

instruments to which that information relates. Breaches of the prohibition regarding insider trading attract the following sanctions:

- Criminal liability punishable by imprisonment for up to 10 years, a fine of up to €171,000, or both;
- Administrative fine by CySEC of up to €855,000 (the upper limit is doubled to €1,710,000 in the event of a repeat violation); or
- Deprivation of the right to trade, directly or indirectly, in financial instruments for a period of five years from the date of the sentence.

Where the person responsible for the violation obtains a gain from the violation, exceeding the sum of the administrative fines specified above, the Commission may impose administrative fines of up to double the amount of the gain. Where a person has been deprived of the right to trade as set out above, a violation of this provision constitutes a criminal offence punishable by imprisonment for up to one year, a fine of up to €8,550, or both.

Deficiencies in Disclosure

Sections 11–14 of the Market Abuse Law impose obligations on issuers of financial instruments regarding disclosure, violations of which may result in the imposition of an administrative fine of up to €342,000 (the upper limit is doubled to €684,000 in the event of a repeat violation). A violation of section 11 also constitutes a criminal offence punishable by imprisonment for up to five years, a fine of up to €85,500, or both.

Market Manipulation

The Market Abuse Law prohibits transactions or orders to trade which give, or are likely to give, false or misleading signals about the supply of, demand for, or price of financial instruments, or which secure, by a person or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level. Such acts of market manipulation are punishable by a fine of up to €855,000. The upper limit is doubled to €1,710,000 in the event of a repeat violation.

Violation of the market manipulation provisions also is a criminal offence punishable by imprisonment for up to 10 years, a fine of up to €171,000, or both, as well as deprivation of the right to trade for a period of five years from the date of sentencing.

Failure to Notify Suspected Insider Dealing or Market Manipulation

A professional who reasonably suspects that a transaction or order to trade might constitute insider dealing or market manipulation must notify CySEC without delay. Failure to do so is punishable by a fine of up to €513,000 (up to €1,026,000 for a repeat violation).

Transparency Requirements Law

Scope of Law

The Transparency Requirements Law, 190(I) of 2007, as amended (the 'Transparency Law'), transposed into domestic legislation EU Directive 2004/109 on transparency requirements for listed transferable securities and, in part, Directive 2007/14, which sets out detailed rules for the implementation of certain provisions of Directive 2004/109.

The Transparency Law applies to all issuers of transferable securities listed for trading on a regulated market which have the Republic of Cyprus as their EU home member state. Transferable securities are categories of transferable securities that are traded on a stock exchange apart from instruments of payment and money market instruments. The Transparency Law does not apply to units issued by and traded in UCITS, unless they are close-ended funds.

The definition of member state of an issuer of shares or debt securities depends on whether the nominal value of the security is less or more than €1,000. In the former case, it is the location of the registered office: in the latter case the issuer may choose between the member state in which its registered office is located or a member state where its securities have been admitted to trading on a regulated market. The choice of home member state remains in place for a minimum of three years, unless the securities are no longer admitted for trading on a regulated market.

Periodic Financial Reports

Issuers must publish accurate and concise information in relation to their business performance and their assets, including annual and half-yearly financial statements and quarterly financial reports.

Continuous Reporting Obligations

An issuer is obliged to report to the public, no later than the end of the day after it was notified, the total amounts of shareholdings in it, as well as any notifications it receives from its significant shareholders (those holding more than five per cent of the issued capital) in relation to their transactions. Issuers also must notify CySEC of any change in:

- Their capital or the total amount of the voting rights attached to their shares (at the end of each calendar month);
- The rights attaching to their shares and derivatives or of any loan agreement into which they enter; or
- Their constitution.

Shareholders' Obligations

A shareholder who acquires or disposes of shares of an issuer whose shares are admitted to trading on a regulated market and to which voting rights are attached

must notify the issuer and the competent authority of the proportion of voting rights held as a result of the acquisition or disposal in the event that the proportion reaches, exceeds, or falls below five per cent (the minimum threshold) and other significant holdings (10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 50 per cent, and 75 per cent). This notification requirement does not apply to:

- Shares acquired for the sole purpose of clearing and settling within a maximum of three days from the date of the relevant transaction;
- Persons holding shares in a custodian capacity, provided that they cannot exercise the voting rights attached to the shares except under instructions given in writing or by electronic means;
- Market makers where the proportion reaches or exceeds five per cent under certain conditions; and
- Shares acquired by the central banks of EU member states in their capacity as monetary institutions.

Special rules apply to investment firms in relation to the investment activity of portfolio management and management companies of UCITS.

Equal Treatment of Stockholders

Issuers must treat all share and bond holders of the same class of transferable securities equally in terms of data protection, the provision of information, and all other aspects of their relationship.

Miscellaneous

Information which is obliged to be disclosed under the Transparency Law and the Market Abuse Law is to be made available and safeguarded under an officially appointed set of procedures in order to ensure easier and more uniform access.

Investment Services and Activities and Regulated Markets Law

In General

The EU Markets in Financial Instruments Directive 2004/39/EC (MIFID), as amended by Directive 2006/31/EC and Directive 2006/73/EC, have been transposed into domestic law by the Investment Services and Activities and Regulated Markets Law, 144(I) of 2007, as amended (the 'Investment Services Law'). Together with Regulation 1287/2006, these Directives are intended to enhance investor protection, to develop a single market in investment services across the EU, and to promote fair and transparent integrated financial markets.

The Investment Services Law, which replaced the Investment Firms Law of 2002, implements MIFID and harmonises domestic law with the relevant EU

directives regarding investor compensation schemes, capital adequacy of investment firms and credit institutions, organisational requirements, operating conditions and record-keeping obligations for investment firms, transaction reporting, market transparency, and admission of financial instruments to trading.

One of the goals of MIFID is a single passport for investment firms, banks, and stock markets to enable them to offer their services on a cross-border basis throughout the EU on the strength of home country authorisations granted on the basis of uniform prerequisites in all member states. According to section 6(5) of the Investment Services Law, the licence to provide investment services is valid in all member states, either through a branch or by simply providing services or activities in any member state.

Section 77 of the Investment Services Law recognises the reciprocal right of investment firms licensed by other member states to operate in Cyprus, provided that their activities are within the scope of the authorisation granted by the home state regulator. Section 4(2) of the Investment Services Law restricts the provision of investment services to:

- Cyprus investment firms authorised to operate under section 6(2);
- Domestic banks and cooperative societies authorised to operate under sections 118 and 122, respectively;
- Investment firms from other EU member states authorised to operate under sections 77(1) and 80(1); and
- Third-country investment firms authorised to operate under section 78(1).

Cypriot investment firms must be licensed by CySEC. Banks and cooperative societies are regulated by the Central Bank of Cyprus and the Authority for the Supervision and Development of Cooperative Societies, respectively. Business descriptions such as investment services, investment activities, regulated market, stock exchange, financial services, stock broking services, broker, or any other similar words in any language may not be used by anyone unless they are licensed according to the provisions of the Investment Services Law.

Any document, publication, or announcement issued by a Cyprus investment firm must include the number of its authorisation and a statement that it is supervised by CySEC. Investment firms must maintain a website showing at least the same information.

The Investment Services Law makes it a criminal offence punishable by a fine, imprisonment, or both, to provide investment services on a paid basis without prior authorisation. Any person found guilty of an offence may be disqualified for up to five years from providing any services regulated by the Investment Services Law. Pending trial, the activities of the person charged may be suspended.

Criteria for Granting Licence

The Investment Services Law sets out the following minimum requirements in terms of capital, management, and investor protection:

- Investment firms providing reception, transmission, execution, portfolio management, and investment advice require a minimum share capital of €200,000. For own account trading, underwriting, and operation of multilateral trading facilities, the minimum capital requirement is €1 million;
- For reception, transmission, and investment advice without handling any clients' funds, the minimum capital is reduced to €80,000. Alternatively, the firm may opt for a lower minimum capital supplemented by appropriate professional indemnity insurance;
- The management of the company must be fit and proper and there must be at least two of them (the four eyes principle);
- The identities and respective interests of the shareholders or the ultimate beneficial owners must be disclosed to and approved by the Commission;
- The company must be adequately resourced with people of the necessary integrity, good repute, skills, and knowledge to enable them to discharge their duties properly;
- The objects clause of the company's memorandum of association must provide that the company operates as an investment company providing the services detailed in its licence issued by the Commission;
- The company's head office must be located in Cyprus, and the company must be a member of the investor compensation fund; and
- Authorisation will be refused if the laws, regulations, or administrative provisions of a third country prevent CySEC from effectively exercising its supervisory functions in respect of the company.

Organisational Requirements

The Investment Services Law also includes a number of organisational requirements aimed at protecting investors' interests. As a minimum, the company must have specific and adequate policies and procedures in the following areas:

- Compliance with the legislation;
- Regulation of personal transactions;
- Protection of clients from any conflict of interest;
- Continuity of operations and services;
- Internal control;
- Proper corporate governance;
- Accounting;
- Segregation and protection of clients' funds;

- Internal audit;
- Risk management;
- Recording of instructions and transactions; and
- Prevention of money laundering.

These must be documented in an internal procedures manual with which all employees must be familiar. There are additional requirements for multilateral trading facilities (MTF) relating to the rules and procedures for trading and criteria for the execution of orders and determination of the instruments, provision of publicly available information and access to such information, access to the MTF, provision of information to users in respect of their responsibility for the settlement of transactions, and procedures to facilitate the settlement of transactions.

Authorisation under Investment Services Law

Applications for authorisation must be submitted to CySEC using the prescribed forms. Once all the required information has been submitted, CySEC must reach a decision within six months. Any decision is subject to judicial review by the Supreme Court under article 146 of the Constitution.

The authorisation will automatically lapse if the holder does not start to use it within 12 months of the date of its issue or if the holder ceases to provide investment services or carry out investment activities for six months.

There also may be a partial lapse affecting only some of the authorised activities. An authorised business may voluntarily surrender its authorisation at any time. The holder is required to inform CySEC of the circumstances and to settle any obligations arising from the discontinued business within three months.

Withdrawal of Authorisation

Section 25 of the Investment Services Law sets out the circumstances in which CySEC may withdraw an authorisation, as follows:

- If it determines that the authorisation was obtained on the basis of false or misleading details or by any other irregular means or if the holder has submitted, notified, or otherwise issued in any way false or misleading information, details, or documents;
- If the holder no longer meets the conditions under which authorisation was granted;
- If the holder has seriously or systematically infringed the operating requirements of the Investment Services Law; and
- If the holder breaches any other domestic legislation which provides for the withdrawal of authorisation.

CySEC specifies on a case-by-case basis how authorisations are (wholly or partially) withdrawn. Once an authorisation has been withdrawn, the affected activities must be discontinued immediately and the related obligations must be settled within three months of the notification of CySEC's decision. Failure to comply is punishable by an administrative fine of up to €350,000.

Where an authorisation has been wholly withdrawn, CySEC will continue to supervise the company concerned until it is satisfied that all its requirements have been complied with. CySEC also may apply to the court for the liquidation of the company and the appointment of a liquidator under the Companies Law.

Suspension of Authorisation

CySEC may suspend an investment firm's authorisation at the same time as it begins withdrawal proceedings. Alternatively, it may temporarily suspend an authorisation for up to three months (which may be extended) as a sanction short of permanent withdrawal.

An authorisation also may be suspended where there is a suspicion of breaches of the Investment Services Law or any associated regulations and directives that threaten the interests of clients or investors or the orderly operation of the capital market. The decision to suspend the authorisation may be taken by the President or the Vice President of CySEC.

Takeover Bids Law

Transposition of Take-Over Directive

Following its accession to the EU on 1 May 2004, Cyprus aligned its legislation with Directive 2004/25 of 21 April 2004 on takeover bids (the 'Take-Over Directive')[17] by means of the Takeover Bids Law, as amended, which was complemented by four directives issued by CySEC.[18]

Facilitation of Takeovers

Takeovers are facilitated by:

- The board neutrality principle — While the bid period is running, the board of the target company may not take any action potentially or actually resulting in the frustration of the bid without the prior authorisation of a general meeting of shareholders;[19]

17 Directive 1/2007 on announcing the intention or final decision to make a bid, *Official Gazette* 4188, Appendix III, Part I, at p 957; Directive 2/2007 on the fees payable concerning the bid, *Official Gazette* 4188, Appendix III, Part I, at p 960; Directive 3/2007 on the content of the bid document, *Official Gazette* 4188, Appendix III, Part I, at p 962; and Directive 4/2007 on the criteria for assessing the expert's independence, *Official Gazette* 4188, Appendix III, Part I, at p 969.

18 See http://www.europarl.europa.eu/oeil/file.jsp?id=226532.

19 Take-Over Directive, art 9.

- The breakthrough rule — The rule neutralises a number of pre-bid defences such as share transfer and voting restrictions, and makes it easier for a successful bidder to replace board members of the target company and amend its articles of association;[20] and
- The squeeze-out right — The right enables a bidder who has obtained a specified level of acceptances compulsorily to acquire the outstanding securities at a fair price.[21]

Member states are free to decide whether or not to make the first two principles mandatory.[22] If they do not, member states may not preclude companies from adopting them voluntarily.[23] Companies also may be allowed to reciprocate against a bidder not bound by the board neutrality or breakthrough rules.[24]

Cyprus did not exercise the option granted by article 12 with respect to the application of article 9 of the Takeover Directive, and the restrictions on frustrating action without shareholders' approval are therefore imposed by law. Article 34(1) of the Takeover Bids Law provides that, apart from seeking alternative bids, the board of the target company may not take any action which may result in the frustration of the bid without the prior authorisation of a general meeting of shareholders. This restriction applies from the time the board becomes aware of a possible takeover bid until the bid is withdrawn or annulled.

In contrast to the board neutrality principle, the breakthrough rule is not mandatory, and its application is left to the discretion of companies. Article 35(1) of the Takeover Bids Law gives a target company with a registered office in Cyprus the reversible option of dismantling any obstacles to being taken over, by decision of a general meeting of shareholders. These obstacles are set out in sub-paragraphs 2–6 of article 35 and include restrictions on the transfer of shares, on voting rights, and on multiple-vote securities. The relevant decision of the general meeting must be immediately notified to CySEC and to the regulated markets in which the target company's securities have been or are intended to be traded.

With regard to the squeeze-out right, article 36(1) of the Takeover Bids Law provides that a bidder who has made an offer to all holders of the target company's securities for all of their securities has the right to require all the holders of any outstanding securities to sell him those securities if:

- He holds securities representing at least 90 per cent of the capital carrying voting rights and at least 90 per cent of the voting rights in the target company;[25] or

20 Take-Over Directive, art 11.
21 Take-Over Directive, art 15.
22 Take-Over Directive, art 12(1).
23 Take-Over Directive, art 12(2).
24 Take-Over Directive, art 12(3).
25 Article 15(2) of the Takeover Directive gives member states the option to set a higher threshold (up to 95 per cent) in the case referred to above, but Cyprus did not avail itself of this option.

- Following acceptance of the bid, he has acquired or has firmly contracted to acquire securities representing at least 90 per cent of the target company's capital carrying voting rights and at least 90 per cent of the voting rights comprised in the bid.

Shareholder Protection

Article 13 of the Takeover Bids Law protects shareholders' interests by requiring anyone who has built a substantial stake in a company to make a full bid. Article 13(1) obliges any person who, as a result of his own acquisition or the acquisition by persons acting in concert with him, holds securities of a company which, added to his existing holdings and those of persons acting in concert with him, directly or indirectly give him 30 per cent or more of voting rights in that company, to make a bid for the outstanding securities. Such a bid must be addressed immediately to all of the remaining shareholders for all their securities at a fair price, determined by CySEC.

Article 18(1) of the Takeover Bids Law stipulates that the fair price must be not less than the highest price paid for the same securities by the bidder or by persons acting in concert with him during the 12 months before the announcement of the decision to launch the bid. CySEC may at its full discretion permit the payment of a lower price in the case of voluntary takeover bids.

Article 37 of the Takeover Bids Law gives shareholders the right to compel a successful bidder for the company to acquire their shares at a fair price. This 'sell-out' right is exercisable under the same conditions as the squeeze-out right. If the bidder holds securities representing at least 90 per cent of the capital carrying voting rights and at least 90 per cent of the voting rights in the target company, or if, following acceptance of the bid, the bidder has acquired or has firmly contracted to acquire securities representing at least 90 per cent of the target company's capital carrying voting rights and at least 90 per cent of the voting rights comprised in the bid, the minority shareholders may require the bidder to buy their securities at the fair price set by CySEC.

Companies to Which Takeover Bids Law Applies

CySEC supervises the application of the Takeover Bids Law and the related directives where the target company has its registered office, and its shares admitted to trading on a regulated market, in Cyprus. If the target company does not have its registered office and its shares admitted to trading on a regulated market in the same member state, CySEC may oversee the bid if any of the following circumstances apply:

- The shares of the target company are admitted to trading only on a regulated market in Cyprus;
- The shares of the target company were initially admitted to trading on a regulated market in Cyprus and subsequently on a regulated market in a member state different from that in which the registered office of the target company is situated; or

- The shares of the target company have been admitted to trading simultaneously on a regulated market in Cyprus and in another member state different from that in which the registered office of the target company is situated, and the target company designated CySEC as the competent authority for the supervision of the bid, announced it to CySEC on the first transaction day, and had its decision published immediately in accordance with the rules set out in section 7 of the Takeover Bids Law.

The Takeover Bids Law regulates the issues relating to consideration of the take-over bid and the bid process if any of these circumstances apply. Issues relating to the information to be provided to the target company's employees, and company law matters, are regulated by the law and the competent authority of the member state in which the registered office of the target company is situated.

Public Offer and Prospectus Law

The Prospectus Law implements Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC. Section 4 prohibits any offer of securities to the public except on the basis of a prospectus which complies with the Prospectus Law and any other relevant law and which has been approved by CySEC.

Government securities are exempt, as are non-equity securities issued by credit institutions, provided that they meet the criteria set out in section 3(2)(f) of the Prospectus Law. Certain offers (those confined to qualified investors, or to fewer than 100 investors, or where the minimum investment per investor is at least €50,000 or where the total amount raised is less than €100,000 in any period of 12 months) are not treated as offers to the public and no prospectus is required. In this case, any material information provided to one potential investor must be disclosed to all investors to whom the offer is exclusively addressed.

Breach of section 4 is a criminal offence, punishable by imprisonment for up to two years, a fine of up to €170,860, or both. In the case of a second or subsequent conviction, both the maximum penalties are doubled.

Section 8 provides that the prospectus should contain all the information necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to the securities. It must comply with the relevant EU Directives regarding information contained in prospectuses as well as the format, incorporation by reference, and publication of such prospectuses and dissemination of advertisements.

The Annexes to the Prospectus Law specify the information required, which must be in a language that is readily comprehensible by potential investors.

Undertakings for Collective Investment in Transferable Securities Law

In General

The Undertakings for Collective Investment in Transferable Securities Law, 200(I) of 2004, as amended, was repealed by the Open-ended Undertakings of Collective Investments in Transferable Securities Law, 78(I) of 2012, which harmonises domestic law with EU Directive 2009/65/EC and other relevant EU Directives and legislation[26] regarding open-ended Undertakings for Collective Investment in Transferable Securities (UCITS) and their products, UCITS management companies, and the marketing of their units (the 'UCITS Law').

The UCITS Law recognises the reciprocal rights of UCITS and their management companies authorised by the relevant authorities of other EEA member states to market their products, offer their services, and operate generally in Cyprus. As the EU directives relating to UCITS are product-based rather than service-based, it is the issuer or the person providing the UCITS products who needs to be authorised and licensed. The relevant authority for authorisation and supervision is CySEC, which is vested with power to issue further directives to clarify the legislative provisions of the UCITS regime.

Recent Developments in UCITS Law

The recent amendments to the UCITS Law are designed to facilitate the provision of management services on a cross-border basis (a so-called 'management company passport' or MCP), including general improvements to the regulatory framework governing the conduct of business and risk management of UCITS; improve retail pre-contractual disclosures regarding funds; facilitate asset pooling (by means of cross-border mergers and a new concept of 'master' and 'feeder' UCITS); and streamline the steps UCITS need to take to be sold cross-border (the notification procedure).

Forms of Undertakings for Collective Investment in Transferable Securities

UCITS within the scope of the UCITS Law may take the form of either a mutual fund or a variable capital investment company, namely a company with variable capital limited by shares.

Scope of Application

The UCITS Law applies to UCITS, management companies registered in Cyprus, and their respective depositaries. A mutual fund is deemed to be domiciled in Cyprus if its management company has both its registered office

26 Directive 2009/65/EC, Articles 11 and 13 of Directive 2010/78/EU, and Commission Regulations (EU) 583/2010 and 584/2010.

and central administration in Cyprus. A variable capital investment company is deemed to be domiciled in Cyprus if it has both its registered office and central administration in Cyprus.

Harmonised UCITS Authorised in a Member State Other Than Cyprus

A UCITS within the meaning of the UCITS Law registered in another member state and holding an operating licence from the competent authorities of its home member state may distribute its units in Cyprus without the need for further authorisation, subject to providing CySEC with a notification letter and the information required under paragraphs 1 and 2 of article 93 of Directive 2009/65/EC and the certifications required in section 3 of article 67 of the UCITS Law, namely its fund rules or its instruments of incorporation, its prospectus and, where appropriate, its latest annual report and any subsequent half-yearly report and its key investor information, together with confirmation that the information and documents fulfill the relevant requirements and that the UCITS fulfills the requirements of Directive 2009/65/EC.

The form and content of the UCITS notification and confirmation letter and the procedure for the exchange of information and the use of electronic communication between CySEC and the competent authorities are set out in Regulation (EU) Number 584/2010.

A UCITS originating from a member state marketing units in Cyprus is required to designate a credit institution to assure the payment, repurchase, or redemption of units of unit holders that are in Cyprus, and to make available the information that UCITS are required to provide.

Marketing Arrangements

UCITS must take adequate steps to ensure that facilities are available in Cyprus for making payments to unit-holders, for the repurchase or redemption of units, and for making available to unit-holders all the information which UCITS are obliged to provide.

Accordingly, CySEC also must be provided with written confirmation from the entity providing these facilities that it has agreed to act as the distributor of the UCITS for the marketing of its units in Cyprus, and details of the arrangements made for the marketing of the UCITS in Cyprus.

Commencement of Distribution

A UCITS may start marketing in Cyprus on notice from CySEC that its marketing arrangements comply with the provisions set out above. CySEC must respond with its final decision within two months after the date on which it receives a complete notification in accordance with the provisions or within six months in the case of a variable capital company that has not appointed a management company.

Distribution on a cross-border basis may commence as soon as the UCITS has been notified by its respective member state authority that it has communicated all necessary information to the host member state authority.

Depositary

Safekeeping of the assets of the UCITS is entrusted to the Depositary, which effectively acts as treasurer of the UCITS.

Depositary duties may be undertaken by a credit institution with a registered office in Cyprus or one established in another member state with a branch in Cyprus, provided always that it is capable of providing depositary and custody services in accordance with the relevant licence and provided it meets the requisite standards with respect to infrastructure and organisation.

Distributors of UCITS Units

Distibution of units is undertaken by the management company or the UCITS itself. The management company or the UCITS, as the case may be, may distribute units through a credit institution, investment firm, or other investment company including the management company, provided that the distributor complies with the requirements of the Investment Services and Activities and Regulated Markets Law and all other Directives issued by CySEC pursuant to the UCITS Law.

Prospectuses, Periodical Reports, and Summarised Statements

The management company for each mutual fund or variable capital company must prepare, submit to CySEC for approval, and publish the following in the prescribed form under the UCITS Law:

- A prospectus;
- An annual report in respect of every financial year;
- A report for the first six months of every financial year;
- A summarised income statement and balance sheet at the end of the first, second, and third quarters of the financial year; and
- A summarised statement of the assets and expenses at the end of the financial year, which includes a profit and loss account and the distribution of profits for the whole financial year.

Publication of Other Information

The net asset value of the UCITS, the number of units, the unit net asset value, and the unit issue and redemption prices must be calculated every working day by the management company or the investment company and made public the day after the next business day in at least two national daily newspapers or by any other additional means as CySEC may determine from time to time pursuant to specific provisions of the UCITS Law.

Non-Harmonised UCITS

There is no legal framework in Cyprus providing for the establishment or incorporation of UCITS that do not fall within the scope of the UCITS Law, ie, non-harmonised UCITS.

However, CySEC has issued directives regarding the establishment of non-harmonised UCITS domiciled in an EU member state and UCITS of third countries in Cyprus and the marketing of their products in Cyprus.

International Collective Investment Schemes Law

In General

The UCITS Law does not apply to international collective investment schemes (ICIS), which instead are subject to the International Collective Investment Schemes Law, 47(I) of 1999 ('the ICIS Law'). An ICIS is a body of a specified form (see text, below) whose sole object is the collective investment of the funds of the unit-holders.

The units of the scheme are redeemed or repurchased directly out of the assets of the scheme at the option of unit-holders, unless otherwise provided by the ICIS Law, any other applicable law, or the constitutional documentation of the scheme. The ICIS Law provides for the designation of three types of ICIS, namely ICIS marketed to the public, ICIS marketed to experienced investors, and private ICIS having a maximum of 100 investors. The policy of the Central Bank of Cyprus ("CBC"), which is currently responsible for regulation and supervision of ICIS, is to accept applications only for private ICIS on the grounds that public funds are supervised by CySEC as UCITS.

Forms of Schemes

An ICIS may take one of the following forms:

- An international investment limited partnership;
- An international unit trust scheme;
- An international fixed capital company; or
- An international variable capital company.

All four legal types of scheme can be of limited or unlimited duration. The ICIS Law is to be amended so as to transfer responsibility for supervision of ICIS from the CBC to CySEC. Applications to the CBC for schemes are currently suspended and only applications for private schemes are being accepted.

Private Schemes

A private international collective investment scheme is defined as a scheme which by its constitutional documentation:

- Restricts the right to transfer its units;

- Limits the maximum number of unit-holders to 100;
- Prohibits any invitation to the public to subscribe for any units of the scheme; and
- Prohibits the issue of bearer units.

Private schemes are obliged to appoint a custodian (which must be a Cyprus bank), unless specifically exempted from this requirement by the CBC. Private schemes which do not have a physical presence in Cyprus also must appoint a company to carry out the administrative work of the scheme; the company must be based in Cyprus and be approved by the CBC. On approval, the CBC provides the applicant with a recognition letter with certain conditions attached to it.

Marketing of Units in Private Schemes

A private scheme is prohibited from inviting the public to subscribe for any of its units. However, the ICIS Law provides that an invitation to an experienced investor does not constitute an invitation to the public.

Experienced Investors

Under the ICIS Law, any person, natural or legal, may be regarded as an experienced investor if that person provides financial services to the public or frequently enters into investment transactions which, on average, are of a substantial size and the person, having regard to all relevant facts, can reasonably be expected to appreciate the risks inherent in investment transactions.

An ICIS designated to be marketed to experienced investors must contain in its constitutional documentation and offering memorandum clearly defined rules and procedures to ensure that marketing of the ICIS is restricted to persons who fall within the definition of experienced investors.

AIFMD

The EU Alternative Investment Fund Managers Directive ("AIFMD") must be transposed into the national laws of EU member states and in operation by 22 July 2013. The AIFMD regulates the hedge, private equity, and alternative investment fund industry in Europe. It imposes organisational, management, and systems requirements on alternative investment fund managers who are either domiciled in the EU or which manage investment funds domiciled in the EU ("AIFM").

The AIFMD permits AIFM that are authorised in accordance with the requirements of the directive and that manage EU-domiciled investment funds (and, from July 2015, non-EU-domiciled investment funds) to market those funds to "professional investors" on a pan-European basis. From 2015, the AIFMD will permit investment managers domiciled outside of the EU, but

which are registered with an EU "reference state" and comply with the requirements of the Directive, to market those funds to "professional investors" on a "passported" pan-European basis.

The AIFMD allows (but does not compel) each EU member state to permit (until July 2018) a non-EU investment manager (that is, a manager that is not domiciled in the EU and which does not manage a fund domiciled in the EU) to market its fund to professional investors in that member state on a private placement basis, but only where the non-EU investment manager (and fund) complies with specified pre- and post-sale transparency requirements, including the requirement for the fund to have an audited annual report.

The AIFMD was transposed into Cyprus domestic law on 5 July 2013 by the Alternative Investment Fund Managers Law, Law Number 56(I) of 2013. This fully harmonises Cyprus law with the AIFMD, the provisions of which are essentially mirrored in the domestic law.

CySEC has issued a series of consultation papers regarding the proposed legislation for Alternative Investment Funds (AIFs) and Collective Investment Schemes with Limited Number of Persons and regarding proposed Directives for the implementation of the new legislation. When the new legislation is enacted, it will, in conjunction with the AIF law, establish the legal framework regulating alternative investment funds in Cyprus. New ICIS will be governed and regulated under the AIF law and responsibility for regulation and supervision of existing ICIS will be transferred from the Central Bank of Cyprus to CySEC. The ICIS Law will most likely be gradually repealed subject to any transitional periods for existing ICIS.

Germany

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Germany

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Introduction

Regulatory System

The structure of market supervision in Germany is complex because market supervision is divided among the federal (*Bund*), state (*Bundesländer*), and (stock) exchange levels.[1] The federal government has passed all relevant securities legislation for which it is competent. The state governments generally have the duty to enforce and monitor compliance with federal laws, unless a statute specifically provides otherwise. New legislation is usually drafted and tabled by the federal administration. As the consent of the Federal Council (*Bundesrat*), the Upper House of the German Parliament, is normally required, the state governments also are involved in the legislation process.

German Capital Markets were reformed by the Fourth Financial Markets Promotion Act taking effect from 1 July 2002. The Act particularly aims at:

- Strengthening the position of the German stock exchanges and their participants in European and international competition;
- Ameliorating the business opportunities of investment funds;
- Strengthening the protection of investors; and
- Ameliorating the efficiency of supervision of, *inter alia*, credit institutions.

Other legislation enacted with substantial impact on German Securities Law includes:

- The Act for the Improvement of the Competitiveness of German Groups on the Capital Markets and for Simplification of Receiving Shareholder Loans (*Gesetz zur Verbesserung der Wettbewerbsfähigkeit deutscher Konzerne an Kapitalmärkten und zur Erleichterung der Aufnahme von Gesellschafterdarlehen/Kapitalaufnahmeerleichterungsgesetz* — KapAEG) of 20 April 1998,[2] allowing the ultimate parent of a group of companies to draw up consolidated financial statements and consolidated business reports for the group in accordance with internationally recognised accounting principles (eg, IAS or United States–GAAP) rather than with the German accounting standards;

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1 Laurenz Uhl, Henning von Sachsen-Altenburg, Antje Kurz, Oliver Dreher, Ulf Starke and Sascha Schuff.

2 The Act for the Improvement of the Competitiveness of German Groups on the Capital Markets and for Simplification of Receiving Shareholder Loans of 20 April 1998, *Federal Law Gazette* (BGBl I) of 23 April 1998, at p 707.

- The Act for the Control and Transparency in the Area of Enterprises (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* — KonTraG) of 27 April 1998,[3] bringing changes to the rules under which companies may buy back their own shares which they may now do in an amount of up to 10 per cent of the company's stated capital;
- The Act for the Introduction of the Euro (*Gesetz zur Einführung des Euro/Euro-Einführungsgesetz* — EuroEG) of 9 June 1998,[4] coming into force on 1 January 1999 and implementing basic changes in the banking and finance area in preparation for the third stage of the European economic and monetary union;
- The Act for Implementation of the European Community Deposit Protection Directive and the European Community Investor Compensation Directive (*Gesetz zur Umsetzung der EG-Einlagensicherungsrichtlinie und der EG-Anleger-Entschädigungsrichtlinie*),[5] coming into force on 1 August 1998 and requiring for first-time credit institutions and investment firms engaging in securities trading to become members of investor compensation schemes which are newly established by the Act as special funds of the German Federal State (*Bund*) under the *Kreditanstalt für Wiederaufbau* (KfW);
- German Act to modernise the law of obligations (*Gesetz zur Modernisierung des Schuldrechts*) of 26 November 2001;
- German Act to Regulate Public Tender Offers for the Purchase of Securities and Company Take-Overs (*Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und von Unternehmensübernahmen*) of 20 December 2001;
- Law regarding an integrated Financial Supervision (*Gesetz über die integrierte Finanzdienstleistungsaufsicht*) of 22 April 2002; and
- The Transparency and Disclosure Act (*Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zur Transparenz und Publizität, Transparenz- und Publizitätsgesetz*) of 19 July 2002.

Legal Sources

There is no single securities statute in Germany. Instead, the relevant provisions concerning the German capital markets and securities are found in numerous laws and regulations, including:

- The Banking Act (*Kreditwesengesetz*);
- The Securities Trading Act (*Wertpapierhandelsgesetz*);
- The Stock Exchange Act (*Börsengesetz*);
- The Exchange Admission Regulation (*Börsenzulassungsverordnung*);

3 Act for the Control and Transparency in the Area of Enterprises, *Federal Law Gazette* (BGBl I) of 30 April 1998, at p 786.
4 Act for the Introduction of the Euro, *Federal Law Gazette* (BGBl I) of 15 June 1998, at p 1242.
5 Act for Implementation of the European Community Deposit Protection Directive and the European Community Investor Compensation Directive, *Federal Law Gazette* (BGBl I) of 22 July 1998, at p 1842.

- The Sales Prospectus Act (*Verkaufsprospektgesetz*); and
- The Sale Prospectes Regulation (*Verkaufsprospektverordung*).

To date, Germany has implemented a number of European Union (EU) Directives on capital market regulations, including:

- The Issuance Directive;[6]
- The Transparency Directive;[7]
- The Admission of Securities to Official Stock Exchange Listing Directive;[8]
- The Listing Particulars Directive;[9]
- The Disclosure Directive;[10]
- The Public Offer Prospectus Directive;[11]
- The Insider Dealing Directive;[12]
- The Money Laundering Directive;[13] and
- The Capital Adequacy Directive.[14]

Authorities

In General

Supervision over the securities markets is organised on the federal, state, and stock exchange levels.

Functional Separation of the Supervising Authorities

In General. There are three major supervising authorities in the area of banking and securities regulations, namely:

- The Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* — BaFin);
- The state exchange supervisory authorities of the different states (*Börsenaufsichtsbehörden der Bundesländer*); and
- The trading supervisory departments (*Handelsüberwachungsstelle*) of each of the stock exchanges.

6 European Community Directive 89/290/EEC, 17 April 1989, OJ L 124/89.
7 European Community Directive 88/627/EEC, 12 December 1988, OJ L 348/88.
8 European Community Directive 79/279/EEC, 5 March 1979, OJ L 66/79, as amended by Directive 82/148/EEC of 3 March 1982, OJ L 62/82.
9 European Community Directive 80/390/EEC, 17 March 1980, OJ L 100/80, as amended by Directive 82/148/EEC of 3 March 1982, OJ L 62/82.
10 European Community Directive 82/121/EEC, 15 February 1982, OJ L 48/82.
11 European Community Directive 89/298/EEC, 17 April 1989, OJ L 124/89.
12 European Community Directive 89/592/EEC, 13 November 1989, OJ L 334/89.
13 European Community Directive 91/308/EEC, 10 June 1991, OJ L 166/77.
14 European Community Directive 98/31/EEC, 22 June 1998, OJ L 204/13.

The separate functions of the BaFin, the state exchange supervisory authority, and the trading supervisory departments are examined below.

Banking Supervision. The BaFin supervises the German credit institutions and investment firms. The regulations concerning the jurisdiction of the BaFin are set forth in the Banking Act. Because the acquisition and disposition of securities on behalf of others, the safekeeping and administration of securities for others, as well as investment transactions qualify as banking business under the Banking Act, the BaFin also has jurisdiction over the securities business of credit institutions and investment firms. The BaFin is in charge of *inter alia*:

- Granting and revoking admission for credit institutions and investment firms;
- Assessing the personal reliability and professional qualification of the managers and non-acceptance of the managers;
- Monitoring the ownership structure of banks;
- Compliance with information and periodic disclosure duties;
- Supervising the economic and financial situation of credit institutions and investment firms, including their liquidity and profitability; and
- Prosecuting illicit banking activities and investment services.

Securities Trading Supervision. The regulations concerning the jurisdiction of the BaFin with regard to the supervision of securities trading are set forth in the Securities Trading Act. The market supervision of the BaFin focuses, in particular, on:

- Compliance with the conduct of business rules applicable to credit institutions and investment firms;
- The prevention of insider dealings;[15]
- Compliance with immediate disclosure duties of issuers;
- Compliance with the disclosure rules for shareholders (transparency); and
- Compliance with the duty to publish securities sales prospectuses in case of public offers in respect of securities not admitted on the Official Market (*amtlicher Markt*) or on the Regulated Market (*geregelter Markt*) of a stock exchange.

The BaFin serves as depository agent for securities sales prospectuses. The BaFin's jurisdiction is not limited to transactions executed on the organised market segments but also covers transactions in the unregulated over-the-counter market. Furthermore, the BaFin represents the German regulators in matters of international co-operation.

15 Market participants, ie, credit institutions and brokers, are required to report all transactions executed within one day to the BaFin regardless of whether such transactions were performed for their own or a third party's account, as provided by section 9 of the Securities Trading Act. The BaFin analyses the information so obtained to determine if there are indications of insider trading. Once any suspicion arises that insider trading has taken place, the BaFin passes the case to the competent public prosecution department.

State Exchange Supervisory Authorities. The state exchange supervisory authorities traditionally had exclusive jurisdiction for the supervision of securities trading. Notwithstanding the creation of the BaFin, the state exchange supervisory authorities still remain responsible for the supervision of the transactions executed on the (state) stock exchanges. While prior to the enactment of the Securities Trading Act, the *Bundesländer* were restricted to supervising merely the legality of the trading, they now also supervise the orderly and proper execution of the transactions.

Trading Supervisory Departments. The trading supervisory departments (*Handelsüberwachungsstelle*) monitor the day-to-day business on the exchanges. The trading supervisory departments supervise:

- Price quotation;
- Proper performance of transactions; and
- Conduct of market participants.

They collect and analyse all available data and information about transactions executed on the stock exchanges, thus monitoring the day-to-day business on the stock exchanges. The trading supervisory departments are obliged to:

- Record stock-market transactions and their settlement systematically and completely;
- Analyse the relevant data; and
- Conduct investigations.

The trading supervisory departments conduct investigations when insider trading is suspected and decide whether to inform the BaFin. They report immediately to the management of the stock exchange and the state exchange supervisory authorities if they discover that exchange rules were violated or actions were committed which might interfere with orderly exchange trading. In addition, the head of the relevant trading supervisory department is obliged to report on a regular basis to the competent state exchange supervisory authority. The head of the relevant trading supervisory department is appointed by the supervisory board of the stock exchange (*Börsenrat*) in agreement with the state exchange supervisory authority.

The state exchange supervisory authorities may give instructions to the trading supervisory department of the stock exchange and take over investigations conducted by the latter at any time. The BaFin, in turn, may give instructions to the state exchange supervisory authorities, in particular if urgent measures need to be taken against insider trading. As exchange brokers qualify as investment firms, the Federal Banking Supervisory Authority has jurisdiction to supervise their solvency.

Other Authorities

German Central Bank. The German Central Bank *(Deutsche Bundesbank or Bundesbank*) is an integral part of the European System of Central Banks (ESCB). The *Bundesbank*, which maintains nine regional offices in the German federal states, participates in the

performance of the ESCB's tasks with the primary objective of maintaining price stability, ensures the orderly execution of domestic and cross-border payments and contributes to the stability of payment and clearing systems. Therefore, the *Bundesbank* has jurisdiction in matters relating to the securities market if they have an impact on currency policy. The *Bundesbank* regularly monitors banks' business. Banks are required to supply the *Bundesbank* with monthly statements about significant developments and provide figures, and the *Bundesbank* prepares statistics on market developments. Further, banks have to report loans exceeding a certain threshold to the *Bundesbank*. If the *Bundesbank* comes to know of any failure by a bank to comply with its duties, it forwards this information to the BaFin.

Securities Board. The Securities Board (*Wertpapierrat*) is established with the BaFin. The Securities Board assists the BaFin in its supervising functions and consists of one representative of each of the federal states. Members of the Ministry of Finance, the Ministry of Justice, the Ministry of Economic Affairs and Technology and members of the Bundesbank may also attend its meetings. The main function of the *Wertpapierrat* is to advise the BaFin about:

- The issuance of rules and regulations;
- The effect of supervision measures on the exchange and market structure and competition; and
- Delimiting competences of the BaFin and the exchange supervisory authorities and questions of co-operation.

Supervisory Board of the Stock Exchange. Each German Stock exchange is required to establish a Supervisory Board (*Börsenrat*) that consists of up to 24 persons. The Supervisory Board's main tasks are to:

- Enact the by-laws and the fee regulations of the respective exchange;
- Appoint and remove members of the managing board of the respective exchange;
- Supervise the managing board of the respective exchange; and
- Enact the business terms and conditions applicable to the transactions executed on the respective exchange.

Co-Operation and Flow of Information among Regulators

In General. Although the responsibilities and jurisdictions for the various areas of the capital markets' matters are split, all the authorities are required by law to co-operate closely.

BaFin and the Bundesbank. The BaFin and the Bundesbank inform each other about observations and findings relevant for the performance of the relevant other side's duties. The BaFin is entitled to use data submitted to the Bundesbank for statistical purposes.

BaFin and Foreign Regulators. Co-operation with the competent authorities outside Germany covers operations in securities, derivatives, money, and currency markets.

Trading Supervisory Department and BaFin. The trading supervisory department must inform the BaFin if it comes to know of information which would be relevant for the BaFin to fulfil its duties (in particular, with respect to insider dealings or stock- and market price manipulations).

Trading Supervisory Department and Foreign Regulators. The trading supervisory department may also transfers information on transactions to foreign authorities competent for supervising foreign exchanges, and it may receive from them data necessary for orderly execution and settlement of exchange transactions. The trading supervisory department must inform the state exchange supervisory authority, the management board of the exchange and the BaFin of the foreign addressee and the type of data it intends to submit.

The management board of the relevant exchange may:

- Suspend market participants based outside the member states of the EU or EEA from trading on the exchange for a term of up to six months; or
- Revoke their admission completely, if the compliance with the duty to provide information pursuant to the Securities Trading Act or the obligations with regard to insider dealings or market price-manipulations is not guaranteed with the competent authority of the state where such a market participant is located.

Legal Order and Regulatory Interests

Admission

Market Participants

German Exchanges. Traditionally, there are basically two categories of market participants on German securities exchanges, namely:

- Credit institutions; and
- Financial services institutions (*Finanzdienstleistungsinstitute*).

Brokers which solely act as intermediaries between the credit institutions and which are divided into two categories — exchange brokers (*Skontoführer*) and free brokers (*Freimakler*) — also qualify as financial services institutions under the Banking Act.

Credit Institutions. In Germany, no clear distinction is made between commercial and investment banking. The Banking Act provides for a list of regulated banking activities and financial services. A credit institution or financial services institution may be licensed for one, several, or all of those banking activities or financial services. Banks holding a full banking licence are permitted to engage in all areas of banking, including

securities transactions (all-round banking, *Universalbankenprinzip*). German banks are the traditional market participants.

German branches of EU credit institutions which fulfil the prerequisites of the 'single passport' regime under the Banking Directive[16] also may act as dealers in Germany without needing further authorisation from the German regulators. They are, in principle, only subject to home member state supervision. German regulators, however, supervise the liquidity of such branches as well as their compliance with the regulations enacted to protect public interests.

Only 'EU credit institutions', as defined in the Banking Directive, qualify for the single passport. Once a credit institution is authorised to conduct these business activities in the EU or EEA member state where it has its registered office, it may apply to its competent authorities for the single passport. Notably, subsidiaries of non-EU/EEA banks having their seat in an EU/EEA member state which hold a banking licence also may qualify as EU credit institutions.

To establish a branch in Germany, the EU credit institution must apply to its competent authority, stating the services it intends to provide in Germany, outlining its proposed programme of operations, and providing the names of the persons responsible for managing the branch. The competent authority is required to notify the BaFin within three months and to inform the applicant about the notice. After a maximum of two months from receipt of this information from the home member state authorities, the applicant may commence its passported business in Germany.

Financial Services Institutions under the Investment Services Directive. The BaFin has jurisdiction over investment firms as competent authorities. Inbound EU investment firms holding a single passport under the Investment Services Directive may carry on their activities without being required to obtain any further authorisation in Germany. In particular, inbound EU investment firms are exempted under the single passport regime from the requirement of obtaining a German banking licence even if their activities would otherwise qualify as banking business under the Banking Act. This is most significant as, of the 'core services' listed in section A of the Annex to the Investment Services Directive, securities business qualifies as banking business under the Banking Act. While domestic firms and branches of foreign (non-EU) investment firms require a banking licence before they may conduct any such business, outwardly passported EU investment firms do not require a German banking licence if they are authorised to conduct these activities in their home member state.

Pursuant to the Investment Services Directive, EU member states are required to ensure that investment firms can, directly or indirectly, become members of or have access to the regulated markets in their host member states. Both the Frankfurt Stock Exchange (Frankfurter Wertpapierbörse) and EUREX acknowledge this obligation and allow

16 European Community Directive 2000/12/EC.

branches of outwardly passported investment firms to become members subject to the same requirements applicable to domestic firms.

Brokers. The Fourth Financial Markets Promotion Act brought fundamental changes to the price determination system on German stock exchanges and to the structure of brokers. The relevant price on German stock exchanges is determined either by use of an electronic trading system or by enterprises admitted for the determination of stock exchange prices which are called 'exchange brokers' (*Skontoführer*). Pursuant to German law, two type of brokers exist: exchange brokers and free brokers.

Exchange brokers may be credit institutions or financial services institutions. Exchange brokers and persons acting on behalf of exchange brokers are admitted by the managing board of the relevant stock exchange. The appointed exchange broker is obliged to carry out the brokerage and the trade of exchange transactions in the securities allocated to him. The exchange broker must conduct his business in an impartial way.

Free Brokers. Free brokers are admitted to the stock exchange by the relevant managing board. A free broker does not fulfil any public function. He may act in the name of his customer or in his own name. Free brokers may trade in all three market segments of a stock exchange.

Transborder Electronic Trading Systems. In 1990, the Frankfurt Stock Exchange introduced new electronic trading systems, providing for the decentralised, remote access to these systems. Today, two electronic trading systems for benchmark products, EUREX and XETRA, are based in Frankfurt, Germany. Both electronic trading systems cater for remote members from abroad who may become remote members of EUREX or XETRA, while being subject to practically the same requirements as domestic firms.

EUREX. In 1998, the German Futures and Options Exchange, formerly known as DTB (*Deutsche Terminbörse*), and the Swiss Futures and Options Exchange SOFFEX merged to create EUREX. The operational and technical merger of the two markets was completed on 28 September 1998. Since then, all DTB and SOFFEX participants have been united on a common trading and settlement platform and the newly established EUREX clearing house has commenced its activities. EUREX is purely a computer exchange and clearing system. EUREX allows direct decentralised access of foreign participants who have their official seat in a state party to the Convention on the European Economic Area, in Switzerland or, since 1996, in the United States.[17] To facilitate access to EUREX outside of Germany and Switzerland, access points have so far been installed in Finland, France, the Netherlands, Spain, the United Kingdom and the United States. Currently, approximately 700 locations worldwide are connected to EUREX.

17 DTB was the first foreign exchange authorised by the Commodity Futures Trading Commission (CFTC) to install trading terminals in the United States.

EUREX membership generally is open to any company fulfilling the following requirements. The company applying for EUREX membership must:

- Engage in securities trading and provide evidence that it is subject to supervision by a banking or supervisory authority in the country of origin;
- Provide to EUREX evidence of the personal qualification and reliability of the persons acting on behalf of the company (ie, the directors of the company);
- If not a credit institution, provide evidence of a paid-up equity capital of at least €50,000;
- Admit and register at least one exchange trader;
- Fulfil the technical requirements of EUREX;
- Participate in the clearing process, either as a General Clearing Member or Direct-Clearing Member, or by entering into a clearing agreement with a General Clearing Member as a Non-Clearing Member; and
- Keep at its disposal IT installations ensuring the orderly processing of trading and settlement through the exchange's electronic system.

All EUREX Members are required to participate in the clearing process as:

- A General Clearing Member (GCM) — A general-clearing licence authorises to clear both members' transactions as well as those of their clients and Non-Clearing Members. All GCMs must have a minimum capital of €125 million and provide a clearing guarantee of at least €5 million.
- A Direct-Clearing Member (DCM) — A direct-clearing licence only authorises to clear a member's own transactions as well as those of its clients. All DCMs must have a minimum capital of €12.5 million and provide a clearing guarantee of at least €1 million.
- A Non-Clearing Member (NCM) — The settlement for the Non-Clearing Member is governed by an agreement to be concluded with a General-Clearing Member.

EUREX currently accepts financial institutions located within the European Union or Switzerland authorised to operate custody business, credit operations and receipt of margin by customers in the form of securities and cash as General Clearing Members or Direct Clearing Members.

XETRA. Xetra is the electronic trading system for the cash market of the Frankfurt Stock Exchange. It was introduced on 10 June 1997, replacing the former IBIS system for share trading and has been continuously updated. The latest updates were made on 1 August 2002 (Release 7) and on 27 March 2003 (introduction of the CCP — the central counter party for the cash market). In the future, XETRA will be enhanced continuously. Through XETRA, investors are able to trade all equities listed on the Frankfurt Stock Exchange. Xetra grants access to almost 6,000 securities from countries world wide and maintains approximately 90 per cent of the market share for all stocks traded in Germany. This includes all securities contained in the DAX, MDAX, TecDAX, SDAX, XTF, and XETRA STARS as well as other stocks, such as shares from the European indices, the

Dow Jones Stoxx 50, the Global Titans 50, and all liquid German government bonds and Jumbo bonds. The minimum trading size for all instruments on XETRA is one share.

Since its introduction, XETRA has almost entirely replaced floor trading in Germany. In accordance with this development, under the provisions introduced by the Fourth Financial Markets Promotion Act, the respective stock exchange may decide at its sole discretion whether the trade will be performed entirely or partly by an electronic trading system and whether there will be an additional price determination by exchange brokers.

Admission to the Frankfurt Stock Exchange or another German securities exchange is required for direct participation in XETRA. Banks, securities trading firms, and brokerages can apply for admission. The main prerequisites are:

- Activity in commercial trading operations in securities;
- Designation of a person who is authorised to manage the business operation and has experience and knowledge in the securities business;
- Status as qualified stock exchange traders;
- Maintenance of an account with the *Landeszentralbank* in Hessen and with Clearstream Banking AG or instruction of such an accountholder to process transactions on the participants' behalf;
- Compliance with the technical guidelines provided by *Deutsche Börse Systems* AG; and
- Conclusion of an XETRA connection agreement.

Development. From the start, both the electronic trading systems experienced steady growth in the number of exchange participants. This growth is bolstered primarily by small firms and specialists from abroad. In contrast, the number of exchange participants admitted to floor trading has been stagnant for years, probably because, in the medium term, decentralised access to the markets is more practical and cost effective. Electronic links are by far cheaper than maintaining staff, premises, information technology installations, and the like on the spot for participation in floor trading.

Furthermore, by providing simpler access to the capital markets in Germany, all German electronic trading systems nurture a growing market for German securities and related products. The share of crossborder trading in the overall volume traded in Germany is high in bonds, derivatives and equities. With its electronic trading systems, the Frankfurt Stock Exchange is a powerful supplier of computerised services for all German stock exchanges.

Designated Sponsor. Since October 1998, credit institutions or investment firms being admitted as market participants may be assigned as designated sponsors for one or more securities being traded on Xetra, the electronic trading system of *Deutsche Börse* AG. For one security, one or more designated sponsors may be admitted. Designated sponsors will ensure a higher liquidity by giving binding prices for the bid and ask side. Except for the stocks listed in the DAX, designated sponsors may be admitted for all shares listed at the Frankfurt Stock Exchange. If supported by a designated sponsor, a security may be traded

continuously instead of being traded in one daily auction only. Securities being listed in the DAX 30, Dow Jones Stoxx 50, Dow Jones Euro Stoxx 50 and the 100 top turnover stocks traded in Xetra may be traded continuously without a designated sponsor.

Securities

National Treatment and Reciprocity. Issuers incorporated in another jurisdiction enjoy national treatment and can list on the German stock exchanges. The listing requirements that apply to foreign issuers in practice are identical to those applicable to domestic issuers. However, securities listed by foreign issuers also must comply with the applicable laws of the issuer's jurisdiction and be freely transferable. Germany has implemented the mutual recognition regime set forth in the Public Offer Prospectus Directive and the Listing Particulars Directive. German regulators and stock exchanges, therefore, do recognise prospectuses which are prepared and approved by the relevant regulator or stock exchange in another EU or EEA member state to be used 'inward', on the basis of mutual recognition, to publicly offer or list securities in Germany. The applicable statutory provisions and the question as to which authority is competent to review and approve of the prospectus depend on whether the offeror seeks listing of the securities (see text, below).

Securities Offerings. Under section 1 of the Securities Sales Prospectus Act, any person publicity offering securities for sale on the domestic German market which are not admitted for trading on a domestic stock exchange must publish a sales prospectus in the German language, unless certain exemptions as set forth in sections 2–4 of the Sales Prospectus Act apply or unless a prospectus for such securities has already been published in accordance with the Securities Sales Prospect Act.

Exemptions. Pursuant to section 2 of the Sales Prospectus Act, the offeror does not need to publish a sales prospectus if the securities:

- Are offered for sale only to persons who, for professional or commercial reasons, acquire or dispose of securities for their own or someone else's account (ie, market participants and institutional investors);
- Are offered for sale to a limited class of persons (ie, private placement exemption);
- Are only offered for sale to employees by their employer or by a company associated with the employer (eg, stock option plans and stock purchase plans);
- Can only be acquired in minimum denominations of at least €40,000 or at an aggregate purchase price of at least €40,000 per investor or if the aggregate price for all securities offered for sale does not exceed €40,000; or
- Are part of an issue or securities for which a sales prospectus has already been published in the German market.

Section 3 of the Securities Sales Prospectus Act constitutes certain exemptions for specific issuers. Among others, a sales prospectus does not need to be published if the securities:

- Are issued by an EU or EEA member state or one of its regional administrative authorities or an international public institution to which at least one EU or EEA member state is party; or
- Are debt securities publicly offered by issuers, including banks and investment firms within the meaning of the Banking Act or the *Kreditanstalt für Wiederaufbau*, or passported branches of EU credit institutions or EU investment firms, which offer debt securities continuously or repeatedly ('constant issuers'). It should be noted, however, that formerly the Federal Securities Trading Commissions followed a very narrow interpretation of the term 'debt securities' under this exemption. Certain equity-linked instruments (ie, so-called reverse convertible notes, which also contain an option element on a specific equity instrument) do not qualify as 'debt securities', and cannot be distributed without an approved sales prospectus.

Section 4 of the Securities Sales Prospectus Act provides for certain exemptions from the prospectus requirements for specific securities, including, but not limited to, those which are:

- 'Euro-securities', which comprise all securities within the meaning of section 1 of the Securities Sales Prospectus Act, including warrants if such securities are not subject to a public advertisement, not offered door-to-door, and are acquired or offered to be acquired and distributed by a syndicate whose members are not based in the same country, a substantial proportion of which are not offered in the country in which the issuer has its seat, and may only be subscribed to by, or initially acquired through, an eligible credit institution or other eligible financial institution; and
- Debt securities with an agreed maturity of less than one year.[18]

Interpretative Statements. The former Federal Securities Trading Commission published several Official Statements ('Statements') on the interpretation of certain terms of the Sales Prospectus Act, including the following:

- Securities — The term 'securities' in the Securities Sales Prospectus Act has a rather broad meaning. It comprises all transferable instruments or security rights which, by their nature, can be traded on a market. Transferable securities within this definition are shares and other tradable securities equivalent to shares, debt instruments, or other tradeable securities equivalent to debt instruments, as well as any other tradeable financial instrument enabling the acquisition of such securities, either by way of subscription or by way of conversion or exchange, or which entitles to a cash payment. The term 'securities' also includes warrants and certificates of participation, both of which are treated as individual classes of securities. Foreign securities which meet the above

18 Sales Prospectus Act, s 4, para 1(8).

criteria are subject to the provisions of the Securities Sales Prospectus Act, irrespective of their classification in their country of origin.

- Public offer — Generally, an offer is deemed to be public if it is directed at the general public and is designed to solicit purchase orders from its addresses. An offer is deemed not to be public if it is directed at a limited group of persons consisting of persons who are individually known to the issuer, approached by the issuer, selected on the basis of individual criteria, and who do not need, in view of their specific knowledge, disclosure by way of a sales prospectus. It is, however, not sufficient for the definition of a limited group of persons that the offer is directed at an unspecified group of persons, an occupational group, or clients who are not further individualised. A public offer, is any form of media or postal advertising directed at the general public which solicits purchase orders. Publications will not constitute a public offer if they are limited to general information about the issuer or its enterprise and/or issues planned in the future. The same applies to information conveyed via electronic dissemination systems and internet publications. A 'Roadshow' where information about the issue is presented to mostly institutional investors is to be considered a public offer if the presentation includes information and price data in relation to a particular security to be issued.

Public offers are 'domestic' offers, if they are targeted at potential investors within the area of application of the securities Sales Prospectus Act. While the Statement fail to comment on whether advertisements in foreign newspapers constitute public offers under the Sales Prospectus Act, this is likely to be the case if and to the extent the newspapers publishing such advertisements, are distributed to the general public in Germany. In the case of internet publications, it is likely that they may constitute, in addition to being public offers under the Securities Sales Prospectus Act, unauthorised offers of securities or investment advisory activities in other jurisdictions, in particular in the United States and the United Kingdom.

The establishment of a personal relationship with the potential investor through the offer itself does not constitute an exemption under the Sales Prospectus Act because such a relationship must be already existing prior to the offer. In view of this requirement, it is unclear whether private placements may be marketed via a net of intermediaries since, in such cases, the issuer (and not the respective intermediary) is the offeror of the securities. Thus, it would not be sufficient if an intermediary has a personal relationship with an investor. The publication of subscription rights in the context of a capital increase in a stock corporation does not constitute a public offer if it is clearly directed only to existing shareholders as a limited class of persons.

Inclusion in the Regulated Over-the-Counter Market (*Freiverkehr*) on one of the regional stock exchanges without any advertising (except the publication of a reference to the quotation and the publication of information about the relevant security to be issued) does not constitute a public offer. Presumably, this also covers the trading of securities in the free market, which would mean that such trading would also not be deemed a public offer. In a book-building process, a public offer generally starts with an invitation to submit a subscription offer at the beginning of the offer period. The pre-market phase in which the issuer or the offeror identify interest from possible investors and determine the basis for

the pricing of the securities is not seen as a public offer. Under the Sales Prospectus Act, the 'offeror' is the person responsible for the public offer of the issue, ie, not necessarily the issuer itself. Especially in the context of underwriting consortiums, the offeror will be the party who, under the underwriting agreement, assumes the responsibility or risk for the issue *vis-à-vis* third parties. Thus, it is likely that the BaFin will regard an acquirer of privately placed securities who offers them publicly for the first time as the 'offeror' of such securities and as the person responsible for the publication of the prospectus.

Procedures. Prior to its publication, the sales prospectus must be submitted to the BaFin. The BaFin is obliged to keep the contents of the sales prospectus confidential. It, however, will determine whether the written document constitutes a sales prospectus in accordance with the applicable provisions of the Securities Sales Prospectus Act. A sales prospectus which has been submitted is treated differently according to whether an application has been made, but not approved, in respect of the relevant securities for admission to the Official Market or the Regulated Market on a domestic stock exchange.

If an application for admission to the Official Market has been filed, but has not been approved, and the securities are to be publicly offered for the first time, a sales prospectus must be published in accordance with the procedural rules set forth in section 9, paragraphs 1 and 2, of the Securities Sales Prospectus Act. Such a prospectus must be approved by the listing office of the relevant stock exchange prior to the public offer or the listing of the relevant securities, but it need not be submitted to the BaFin. In the event that an application for admission to the Regulated Market has been filed but has not yet been approved and published in accordance with the Stock Exchange Admission Regulation and the exchange regulations of the relevant stock exchange, and the applicant wants to offer the relevant securities to the public, the applicant must submit to the BaFin a sales prospectus drafted in accordance with the Securities Sales Prospectus Act and the Sales Prospectus Regulation. When submitting the sales prospectus to the BaFin, an offeror should inform the BaFin about the following:

- When and in which nationwide newspaper approved by the relevant exchange the sales prospectus will be published, or a notice to that effect will be given; only shortly before the date of the public offer, provided that the sales prospectus indicates how such information will be made available subsequently and provided further that such additional information is published in accordance with the Securities Sales Prospectus Act. An incomplete sales prospectus must indicate that it is incomplete. Non-verified fictitious data may not be used. Instead, the incomplete sales prospectus must indicate any gaps there may be with respect to certain terms and conditions. As to the definition of the phrase 'certain terms of the issue', the BaFin takes a very restrictive view. The phrase 'certain terms of the issue' only applies to such terms and conditions of an issue which, because of their special nature, can only be determined shortly before the offer is made public, such as issue price, interest and maturity;

- When the notice (under section 9, paragraph 3, of the Sales Prospectus Act) will be published in the *Federal Gazette* (*Bundesanzeiger*); and
- The date of the first public offer.

According to section 9, subsection 3 of the Securities Sales Prospectus Act, the notice has to contain information about where the sales prospectus can be found on electronic information systems (eg, the internet) if the sales prospectus is being published in this manner.

If the sales prospectus is to be published in an nation-wide newspaper approved by the relevant stock exchange, the date on which such a newspaper is published is deemed to be the publication date with regard to the securities. With respect to multiple-day issues (eg, the Friday–Saturday edition of the *Handelsblatt*, or special holiday editions), the first day of such editions will be deemed the date of publication. The deadlines may be met either by depositing the sales prospectus in the 'deadline mailbox' of the BaFin or by telefax transmission of the sales prospectus. A telefax transmission is only sufficient if:

- The telefax is identical to the original sales prospectus;
- The telefax contains the signatures of the issuer; and
- The original sales prospectus is submitted thereafter to the BaFin without undue delay.

The sales prospectus must be published at least one full business day[19] prior to the public offer. Hence, if a sales prospectus is published on a Monday, then the corresponding public offer may not be made before Wednesday of that week. A notice under the Securities Sales Prospectus Act which needs to be published in the *Federal Gazette* should be timed as closely as possible to the date of publication of the sales prospectus. If a book-building process takes place, the sales prospectus must be published one full business day before the start of the offer period during which investors may submit their subscription bids. It is recommended to describe the chronology of the book-building process in the sales prospectus.

Incomplete Sales Prospectus. An incomplete sales prospectus may be published without certain terms of the issue in cases where such terms can be determined only shortly before the public offer, provided the sales prospectus indicates how such information will be made available subsequently and provided further that such additional information is published in accordance with the Sales Prospectus Act. Incomplete sales prospectuses must indicate that they are incomplete. Non-verified fictitious data may not be used. Instead, the incomplete sales prospectus must indicate any gaps there may be with respect to certain terms and conditions. As to the definition of the phrase 'certain terms of the issue', the BaFin has taken a very restrictive view. The phrase 'certain terms of the issue' only applies to such terms and conditions of an issue which, because of their special nature, can only be determined shortly before the offer is made public.

19 Saturday is deemed to be a business day for this purpose.

In the case of an incomplete sales prospectus for the issuance of warrants, such incomplete sales prospectus must contain a general description of the underlying instrument given (eg, whether the underlying instruments are shares, indices, currencies, commodities, interest rates, or futures).

The BaFin accepts the accumulation of several incomplete sales prospectuses in one document. In the case of shares or bonds, the market segment (Official Quotation, the Regulated Market, or the Regulated Over-the-Counter Market) on which such securities are traded must be described. In addition, in respect of bonds, the incomplete sales prospectus must identify the issuer. Finally, in respect of foreign exchanges, the currency zone must be indicated.

Supplementary information to the incomplete sales prospectus must be submitted to the BaFin as soon as it is available and must be published on or before the date of the public offer under the Securities Sales Prospectus Act. In the event that the publication is made by way of a public notice stating where the supplementary or complete sales prospectus is available, such notice must be made for each submission of supplementary information to the BaFin. All supplementary information is deemed to be a part of the relevant public offer and must be submitted to the BaFin, either through its 'deadline mailbox' or by telefax transmission. Any reference to future supplementary information is prohibited. The supplementary information must be clearly identified as such, and it must be linked to the respective incomplete sales prospectus as well as to all other supplementary information in respect of the same prospectus. Different filings of supplementary information may be combined in one publication if appropriately designated. The BaFin will not raise objections against the distribution of a sales prospectus made up of a former incomplete sales prospectus and attached supplementary information, provided this contains the same information for the investor as a complete sales prospectus for the investor.

It has always been controversial whether the former Federal Securities Trading Commission and the Federal Financial Supervisory Authority have exceeded the authority given to them by the Securities Sales Prospectus Act. Under the Sales Prospectus Act, the former Federal Securities Trading Commission was, and the BaFin is, only authorised to sanction if a sales prospectus is intentionally or negligently not (or not in due time) published or submitted to the regulator. The regulator does not have the authority to sanction the publication or submission of a sales prospectus if it contains inadequate or incorrect information. Rather, whether a sales prospectus is adequate and correct or not, is a question to be answered in the compensation claim of an investor.

Mutual Recognition. If no application to list the securities for Official Quotation or a Regulated Market has been filed, the Federal Financial Supervisory Authority has jurisdiction. The offeror must file with the BaFin:

- The prospectus and a translation thereof into the German language;[20] and

20 The BaFin may waive the translation requirement in whole or in part if the prospectus is written in a language which is not uncommon for securities trading in Germany. For the time being, only prospectuses in the English language may be used. The BaFin does not acccept prospectuses in any other European language.

- A confirmation from the competent authority of the home member state approving of the prospectus.

In the case of mutual recognition, the offeror must deposit the prospectus with the BaFin prior to its publication and publish the prospectus either in a transregional exchange journal (eg, *Börsen-Zeitung*) or by making it available at the offices of the paying agent named in the prospectus.

If an application for admission to list the securities for Official Quotation or a Regulated Market has been filed, but not yet approved, and the securities are to be offered publicly for the first time, the listing office (*Zulassungsstelle*) of the relevant official exchange or listing committee (*Zulassungsausschuß*) of the relevant regulated market has jurisdiction, respectively. The listing office or listing committee, as the case may be, is required to approve of the prospectus without any further review, provided that:

- The prospectus and a translation thereof into the German language have been filed;[21]
- The prospectus had been approved by the competent authority of the home state and a confirmation of approval has been filed; and
- The home state authority had not derogated or waived any prospectus requirements.

The offeror must publish the prospectus once it has been approved either in a transregional exchange journal (eg, *Börsen-Zeitung*) or by making it available at the offices of the paying agents named in the prospectus.

Listing Requirements. Different listing requirements are applicable to listings on the Official Market, on the Regulated Market, or on the Regulated Over-the- Counter Market (*Freiverkehr*).

Listing on the Official Market. The procedure and prerequisites for listing securities on the Official Market of a German stock exchange are governed in particular by sections 30–48 of the Stock Exchange Act and the Stock Exchange Admission Regulation. Application for listing on the Official Market must be filed with the listing office (*Zulassungsstelle*) of the relevant stock exchange by the issuer jointly with a credit institution admitted to trading on a German stock exchange as listing sponsor. If the issuer is itself a credit institution, the issuer may file the application alone. The application for listing must be made in writing and contain:

- The name and place of business of the issuer;
- The type of securities to be listed;
- The nominal value of the securities; and

21 The listing office may waive the requirement that a translation be filed in whole or in part if the prospectus is written in a language which is not uncommon for securities trading in Germany (only English language prospectuses are accepted).

- The official mandatory stock exchange journal (*Börsenpflichtblatt*) wherein the application will be published (eg, *Börsen-Zeitung*).

The issuer must state whether:

- It filed a similar application in the past;
- It made application at the same time at another stock exchange in Germany or in another member state of the EU or EEA; or
- Such an application will be filed in the near future.

The application must be published in the *Federal Gazette* and in the official mandatory exchange journal and announced at the stock exchange where the securities will be listed. The application must be accompanied by a listing prospectus which contains the information required under the Stock Exchange Act and Exchange Admission Regulation to enable the public to correctly evaluate the issuer and the securities. Admission will be granted no earlier than three working days after the first publication of the application. Securities admitted to trading may be introduced to the stock exchange, ie, the price quotation may commence on the next day after the first publication of the prospectus or, if the issuer is exempted from publishing a listing prospectus, after publication of the admission.

In cases of compliance with all formal requirements, the securities will be admitted to trading, unless there are circumstances known under which the admission of the securities would lead to fraud or misrepresentation to the public or would damage a material public interest. Bonds or notes issued by the federal government, its special asset facilities, a state, or a member state of the EU or EEA are *per se* admitted to the Official Market of any domestic stock exchange. Shares of an issuer having its registered seat in a state outside the EU or EEA and which are not officially listed in such a state or in the state where the shares are mainly distributed may only be admitted if the issuer can show that listing there was not withheld to protect the public.

Securities must be issued in accordance with the laws applicable to the issuer, and they must comply with the statutes and regulations applicable to such securities which must be freely transferable. In the case of shares, their estimated fair market value or, if an estimation is not possible, the stated capital of the issuer, must be at least €1,250,000, unless shares of the same class have already been listed on that stock exchange. If securities other than shares are to be listed, the total nominal value must be at least €250,000. If the securities have no par value, the minimum number of such securities must be at least 10,000. However, the listing office may exempt the issuer from these requirements if it believes that a sufficient market for the securities will emerge.

The par value of securities, in particular small par values and the number of securities issued, must meet the needs of orderly exchange trading and the public. The application for admission of shares must relate to all shares of the same issue. However, the application need not comprise shares which are part of a holding to maintain control over the issuer or which may not be traded for a certain time, provided that it is unlikely that the partial admission of the shares will be to the detriment of potential investors. In case of

partial admission, the listing prospectus must state that admission is filed for only a part of the issue and the reasons therefor; if a listing prospectus need not be published, the public must be informed of the partial admission in another appropriate way. An application for admission of securities other than shares, however, must always cover all securities of the same issue.

Shares must be sufficiently distributed among the public (free float) in one or more member states of the EU or EEA. A sufficient free float is deemed to exist if:

- At least 25 per cent of the total nominal value of the shares subject to the listing or, if the shares have no par value, 25 per cent of the number of certificates have been acquired by the public; or
- The number of shares of the same class is so large and their distribution to the public so broad that orderly trading on the Stock Exchange is warranted.

Notwithstanding the above requirements, shares may be admitted if:

- The issuer intends to, and the listing office believes that the issuer will, achieve sufficient distribution within a short period of time after introduction of the securities on the stock exchange;
- Shares of the same class have already been listed on an official market within the EU or EEA, and sufficient distribution will be achieved by taking into account the total number of shares issued; or
- The shares have been listed on an official market outside the EU or EEA and sufficient distribution to the public has been achieved in these states.

An issuer seeking a listing for Official Quotation must have existed as a business operation for at least three years and must disclose the annual financial statements for the three years preceding the filing date of the application. The listing office may exempt the issuer from the three-year period requirement if the entities that comprise the business of the issuer existed for at least three years and pro forma statements are submitted.

In respect of securities not fully paid in, the listing office may admit:

- Securities which are not fully paid in, if exchange trading will not be adversely affected thereby, the listing prospectus explicitly states that payment had not been made in full, and it indicates the applicable procedure or, if a listing prospectus needs to be published, the public had been informed that payment in full had not been made; and
- Shares requiring a consent for the transfer of title, provided that such requirement for consent does not adversely affect orderly exchange trading.

Subscription rights or convertible securities may only be admitted if the securities to which the conversion or subscription rights relate are already admitted to trading on a domestic stock exchange or are included in the Regulated Over-the-Counter Market or will be admitted or included concurrently. The listing office, however, may admit such rights or securities if the securities to which the conversion or subscription rights relate are admitted to trading on an organised market within the EU or EEA, and the public can

regularly obtain the price quotation for these securities from the foreign markets. The listing prospectus must contain information about how the public in Germany can obtain such information.

Certificates representing shares may be admitted if:

- The issuer of the shares represented by the certificates has signed the application for admission;
- The issuer has complied with the requirements applicable to the issuer and the minimum amount requirement;
- The issuer has submitted to the listing office a written covenant stating that it will comply with the duties that are usually imposed on issuers of listed shares;
- The certificates comply with the general conditions applicable to securities; and
- The issuer of the certificates covenants that it will comply with its obligations to certificate holders.

If the certificates represent shares of an issuer having its place of business in a country outside the EU or EEA and if the shares are not listed on an official market of a stock exchange in such country or in the country where the shares are mainly distributed, the applicant must demonstrate that a listing in that country was not omitted to protect the public.

If certificated securities are issued they must be printed at a standard which provides adequate protection against forgery and falsification and facilitates easy and safe execution of transactions. In the case of securities of an issuer with its place of business in another member state of the EU or EEA, it suffices that the securities are printed in compliance with the regulations of that state. If the printing standards do not provide sufficient protection against forgery and falsification, the prospectus must contain a notice to that effect; if a prospectus need not be published, the public must be informed appropriately.

Delisting. On request of the issuer, the admission office may delist the issuer. Delisting may, however, not be contrary to investors' interests. Further regulations for delisting are contained in the exchange rules of the respective stock exchange.

Listing on the Regulated Market. Listing on the Regulated Market (*geregelter Markt*) is, in essence, regulated by the exchange rules of the respective stock exchange. In particular, the exchange regulations contain rules about the procedures for admission. Although each stock exchange has its own exchange regulations, the rules applicable for listing on the Regulated Market do not differ substantially. The listing office (*Zulassungsstelle*) of the relevant stock exchange decides on the listing on the Regulated Market. The application must be filed by the issuer together with a credit institution admitted to trading on a domestic stock exchange. If the issuer itself is such a credit institution, it may file the application alone. The exchange regulations contain provisions under which the managing board of the stock exchange may allow enterprises other than

credit institutions to apply together with the issuer for admission of the securities. Securities will be admitted to the Regulated Market if:

- The issuer and the securities comply with the formal requirements necessary for orderly trading on the stock exchange; and
- The application is accompanied by a business report for publication signed by the issuer.

Admission is refused if circumstances are known under which admission of the securities would mislead the public or would substantially damage public interest. Bonds issued by the federal government, its special funds, a state, or another member state of the EU or EEA are *per se* admitted to the Regulated Market on any domestic stock exchange, unless they have been admitted to the Official Market.

Securities will be admitted to the Regulated Market if the issuer and the securities comply with the formal requirements necessary for orderly trading on the stock exchange. Further, the application must be filed together with a business report for publication containing information regarding the issuer and the securities in order to enable potential investors to take an informed decision concerning an investment in the securities. The business report must, as a minimum requirement, contain the information required for a prospectus in a public offer of securities.

Mutual Recognition. Listing particulars prepared in another European Union or EEA member state may be used 'inward', on the basis of mutual recognition, to list securities on an official exchange in Germany if the following requirements are met:

- The issuer being domiciled in another EU or EEA member state has filed a listing application simultaneously or nearly simultaneously both on an exchange in its home member state and on an official exchange in Germany;
- The prospectus and a translation thereof into the German language has been filed with the listing office of the relevant exchange;[22]
- The prospectus has been approved by the competent authority of the home member state and a confirmation of approval has been filed with the listing office; and
- The home member state authority had not derogated or waived any prospectus requirements.

The listing office may require additional information to be included in the prospectus, *inter alia*, with regard to domestic paying agents, the German income tax system, and the method of notification of investors. These rules apply *mutatis mutandis* if an application for listing of the securities on the Regulated Market is made.

Trading participants may apply for inclusion of securities on the Regulated Market. This allows securities to be included and traded on the Regulated Market at facilitated

22 The listing office may waive the requirement that a translation be filed in whole or in part if the prospectus is written in a language which is not uncommon for securities trading in Germany (only English language prospectuses are accepted).

conditions without the need for a listing. To be eligible for inclusion in the Regulated Market securities must already be listed on:

- An official market or regulated market in Germany;
- An organised market in the EU or EEA;
- An organised market in a third country with similar listing and transparency rules; or
- Where an exchange of information with the respective supervisory authorities is ensured. Further, no facts must be known that might lead to damage to investors or public interests.

Inclusion in the Regulated Over-the-Counter Market. Securities which are not admitted to the Official Market or the Regulated Market or included in the Regulates Market or the Regulated Over-the-Counter Market (*Freiverkehr*) must not be traded on the exchange floor during the business hours of the stock exchange, and the making of an open outcry for securities not listed or included is prohibited. The stock exchanges may only allow over-the-counter trading in securities which are not admitted to the Official Market or to the Regulated Market, provided that there are trading regulations in force that ensure that trading and settlement will be conducted in an orderly manner. Such regulations, as well as the conditions precedent for inclusion and the applicable procedures, are set out in the Guidelines for Regulated Over-the-Counter Trading (*Richtlinien für den Freiverkehr*) of the respective stock exchanges.

On application, securities may be included in the Regulated Over-the-Counter Markets of the respective stock exchanges. The conditions precedent for inclusion as well as the applicable procedures are set forth in the Regulated Over-the-Counter Market Guidelines of the respective stock exchanges. The rules set out below are based upon the Frankfurt Regulated Over-the-Counter Market Guidelines as enacted by *Deutsche Börse* AG (sponsor to the Frankfurt Stock Exchange), which also decides upon the inclusion of securities in the Regulated Over-the-Counter Market of the Frankfurt Stock Exchange.

The application for inclusion must be filed by an enterprise that has unlimited admission to trading on the Frankfurt Stock Exchange. The issuer will be notified by *Deutsche Börse* AG of the intended inclusion. The inclusion will not take place if the issuer objects unless the issuer has its seat in a member state of the EU or EEA or other countries specified in the Regulated Over-the-Counter Market Guidelines (*inter alia*, Canada and the United States). The application for inclusion must contain an exact designation of the securities and information on the domestic or foreign organised markets where prices for such securities are already quoted. For securities for which such quotes are not available, the applicant must provide further information on the issuer in form of an Exposé. For inclusion purposes, the applicant must determine a paying and depositary agent within Germany. The applicant must ensure orderly trading on the stock exchange requiring the applicant, *inter alia*, to immediately inform *Deutsche Börse* AG of forthcoming shareholders' meetings, dividend payments, changes in the capital structure and other information substantially affecting the evaluation of the securities or the issuer.

Listing of Futures and Options on Stock Exchanges. The execution of futures and options contracts on a stock exchange requires the admission by the managing board in accordance with the exchange regulations of the relevant stock exchange. Prior to admission, the managing board of the stock exchange must determine the terms and conditions for such trade and, in the case of commodities, the managing board must in each case hear the expert opinion of representatives of the business circles concerned. Admission of securities to exchange futures and options trading may only be granted if the total number of underlying securities subject to such trading attains a nominal value of at least €5 million. Futures in shares of a German company may only be admitted to exchange futures and options trading if the issuer has given its consent.

At the request of the issuer, the admission will be revoked, provided that such request is made to the managing board within one year of admission. In the event that the price for exchange futures and options contracts is subject to the official price quotation, the quotation procedures which apply to securities also apply to the futures and options transactions. In the event that stock exchange futures and options trading is executed on an exchange in a form that deviates from the terms and conditions set forth by the managing board, or if commodities or futures or options are traded which are not admitted to exchange futures trading, the managing board must order such trading to stop and exclude the relevant dealer from making use of the facilities of the stock exchange. On exclusion, price lists for such transactions may not be published or disseminated as copies.

Introduction of Products on EUREX. The management of EUREX has discretion to decide on the products to be admitted for trading on EUREX. Prerequisites for the 'introduction' of any derivative product are that orderly trading in such product is ensured and that the market-maker function is fulfilled. 'Product' means any option or future contract relating to a certain base value; 'base value' means the respective 'object' to which such contract relates. The resolution of the management to the introduction of new products must be published. In contrast to the listing on a stock exchange, there is no specific right for an applicant to have particular products listed on EUREX and, naturally, there are no issuers. The futures contracts are synthetic products.

If it is necessary for the protection of the public, the management board of EUREX may revoke or suspend the admission of certain products, in particular if the quotation of a security to which the contracts relate has been suspended on the stock exchange. During such suspension no orders or quotes may be entered into the system and the positions may not be liquidated. Any existing orders and quotes will be cancelled. The re-commencement of trading in suspended contracts starts with the pre-trading period. The management, however, may decide otherwise. The management may exclude effective delivery in respect of futures contracts if this is necessary for orderly trading. In this case, all rights and obligations are deemed to be fulfilled with the last payment at the end of the term for such contract. The management also may exclude the exercise of options related to shares and provide for settlement in cash instead of actual delivery. The amount to be paid is then to be determined according to the difference between the average of the opening, cash market and closing prices, and the basis prices of the option multiplied by the number of shares to which the option relates.

Prospectus Requirements. Prospectus requirements are imposed for listing on the Official Market and for listing on the Regulated Market.

Listing on the Official Market. The Exchange Admission Regulation requires that an information sheet, the listing prospectus, or 'listing particulars', complying with the disclosure requirements of the Exchange Admission Regulation and a prescribed format, be filed and approved for admitting securities to be listed on the Official Market on any securities exchange in Germany. Matters to be disclosed include, *inter alia*, information concerning:

- The parties responsible for preparing the listing particulars and auditing the financial statements;
- The securities and the listing application;
- The capitalisation of the issuer;
- The issuer's principal business activities, including a breakdown of net turnover by category and geographical markets for the past three years, material contracts, patents, licences, legal proceedings, employees, and investment policies;
- The issuer's assets and liabilities, financial position, and profits and losses;
- The issuer's administration management and supervision, including remuneration, unusual transactions, and equity interests; and
- Recent developments and prospects of the issuer.[23]

The listing office may grant an exemption in whole or in part from the duty to publish listing particulars for admission to the Official Market if the securities concerned:

- Were subject to an initial public offering or were issued in connection with a public tender offer, a merger, a split, an acquisition of all or part of the assets of a company, or as consideration for contributions in kind, provided a written description was published in Germany within 12 months prior to admission;[24]
- Were distributed to the owners of shares listed on the Official Market on the same stock exchange through an increase in the stated capital of the issuer from retained earnings;
- Were issued as shares through the exercise of conversion or subscription rights attached to other securities provided that the shares of the company whose shares are offered for conversion or subscription are listed on the Official Market on the same stock exchange;
- Were issued in lieu of shares listed on the Official Market of the same stock exchange, unless the issuance of such new shares is linked to a change in the stated capital and the

23 Different disclosure requirements apply to bonds and shares.

24 The description must (a) be available to the public at the places of business of the issuer and the paying agents; and (b) supply all information that would have to be disclosed in a listing prospectus (all information which has occurred since the preparation of such a description which has a material effect on the evaluation of the issuer and the securities must be published in accordance with the publication procedure for a listing prospectus).

information required to be given in respect of shares was published in accordance with the publication procedure for sales prospectuses;

- Have been admitted to the Official Market of another German stock exchange and a listing prospectus was published for such securities;
- Are shares and their number, estimated fair market value or par value or, if the shares have no par value, their fair market value, is less than 10 per cent of the number or value, as the case may be, of shares of the same class listed on the Official Market on the same stock exchange, provided the issuer has complied with the publication requirements for the admission; shares which differ only as to the date for accrual of the dividends are deemed to be in the same class;
- Are issued to employees, if shares of the same class are listed on the Official Market on the same stock exchange;[25]
- Are issued in consideration of a waiver, in part or in full, by the personally liable partners of a limited partnership based on shares, of their rights to the profits under the articles of the partnership, provided shares of the same class are listed on the Official Market on the same stock exchange;[26]
- Are bonds or notes issued by legal entities which (a) have their place of business in a member state of the EU or EEA, (b) conduct their business under a state monopoly, and (c) have been established by a specific statute or by virtue of a specific statute or are regulated by such statute, or bonds or notes for which the payment of interest and principal is unconditionally and irrevocably guaranteed by a member state of the EU or EEA or one of the federal states of such member state, if any;
- Are bonds or notes issued by legal entities other than companies, such legal entities having their place of business in a member state of the EU or EEA and which were established by a specific statute, provided the sole purpose of such legal entities is to raise capital under governmental supervision by issuing bonds or notes to finance the production of goods or the rendering of services, the bonds or notes of which, for purposes of admission onto the Official Market, are treated under the law of their home country as being legally equivalent to bonds or notes issued by the government or for which the government guarantees payment of interest and principal; and
- Are certificates representing shares issued in exchange, unless this is accompanied by a change in the stated capital, provided certificates representing such shares are listed on the Official Market on the same stock exchange and provided further that information about the number and type of securities to be admitted and the terms for their issuance are published in the same manner as that for a listing prospectus.

The listing office may allow certain information to be omitted from the listing or to be published in a summarised prospectus for admission to the Official Market only if the securities concerned are, by reason of their characteristics, only purchased normally by

25 Shares which differ only as to the date for accrual of the dividends are deemed to be in the same class.

26 Any shares which differ only as to the date of accrual of the dividends are deemed to be in the same class.

sophisticated investors who usually trade such securities among themselves, unless such information would have been material to these investors. The listing office may further allow information to be omitted from a listing particular which would otherwise be required, if it believes that:

- Such information is not material and not likely to influence the evaluation of the net worth, the financial situation and earnings, and the prospective business development of the issuer;
- The dissemination of such information would be contrary to the public interest; or
- The dissemination of such information would cause substantial damage to the issuer, provided omission does not mislead the public about any material information.

If an application for listing to the Official Market has been filed, the listing prospectus, prior to its publication, must be approved by the listing office of the stock exchange where the application for listing was filed. If the issuer filed its application at several domestic stock exchanges, the issuer may appoint one of the listing offices to be competent for granting such an approval. The listing office must decide on approval within 15 stock exchange days after receipt of the listing particulars. Furthermore, the listing office monitors that the duties of the offeror are complied with and must issue a certificate approving the listing prospectus on request of the offeror.

If securities also are to be publicly offered in another member state of the EU or EEA, the offeror must forward a draft of the listing prospectus to the competent authorities of that other state. The listing offices co-operate with the competent authorities in the other member states of the EU or EEA, according to their competencies, and forward to each other the necessary information, as long as confidentiality is observed. Insofar, the members and employees of the listing offices are released from their duty to secrecy. If securities to which subscription rights are attached are subject to the offering by an issuer having its place of business in another member state of the EU or EEA and having its shares listed on an official market in this state, the listing office, prior to its decision, must obtain a statement from the competent authority of that other state.

If the securities of an issuer having its place of business in another member state of the EU or EEA are to be offered publicly simultaneously or almost simultaneously both in that state and domestically, the listing office must approve the listing prospectus without passing on its contents if the listing prospectus were approved by the competent authority of that other state, provided it has received a translation of the prospectus in the German language and a written confirmation from the competent authority of that other state that it has approved the prospectus. If the competent authority of the other member state of the EU or EEA had granted an exemption for certain information or had permitted deviations from otherwise statutorily prescribed matters, the listing office will only approve the listing prospectus if:

- The exemption or deviation also is permissible under the German laws and regulations on listing particulars;
- The same circumstances which justified the exemptions also exist within Germany; and

- The exemption or deviation is not subject to any further contingency which would cause the listing office to refuse the exemption or deviation.

Issuers who have been admitted to listing in a regulated domestic market for at least two years may be exempted from issuing a listing prospectus when applying for admission to the Official Market. In this respect, issuers which have been officially listed on a recognised exchange in the EU or EEA for at least three years may be allowed to be listed in Germany on the basis of abbreviated listing particulars without having to publish a full prospectus. Moreover, the prospectus verification is limited to one listing authority, and a foreign language prospectus is accepted by the relevant listing office without translation, provided certain conditions are met. Currently, the Frankfurt Stock Exchange accepts foreign language documents only if they are drafted in the English language. Languages from other EU member states are not accepted.

No listing prospectus for the admission of shares to the Official Market is required if the relevant shares have been listed for at least two years on the Regulated Market of a domestic stock exchange. No prospectus must be published if securities of a foreign issuer have already been listed on the Official Market on a stock exchange in another EU or EEA member state for at least three years and certain further requirements are met. If securities are to be listed simultaneously on more than one domestic stock exchange, the issuer may select the listing office which shall be competent to approve of the listing prospectus.

Listing on the Regulated Market. An issuer seeking listing on the Regulated Market must publish a so-called 'business report'. The business report must contain all material information on the factual and legal situation of the issuer and the issue and must be correct, complete, and signed by the applicant. In particular, information about the development of the issuer, the current business situation, and the business prospects, as well as the latest published financial statements, must be provided. The business report needed for listing on the Regulated Market must be submitted in the German language. In the case of a listing on the New Market, the business report also must be published in the English language.

An issuer of securities listed on another domestic stock exchange either on the Official Market or on the Regulated Market is exempted from submitting a business report, in the case of debt securities, if less than three years, and, in the case of securities other than debt securities, if less than six months, have elapsed since the latest publication of the business report or listing prospectus, as the case may be. The exchange regulations may provide for other circumstances under which an issuer is exempted from submitting a business report, provided the public can be adequately informed otherwise.

Prospectus Liability. In the case of listed securities, no prospectus liability exists unless the relevant securities were acquired within six months from the date of commencement of trading on a German stock exchange. The same applies *mutatis mutandis* to securities not admitted to trading on a stock exchange: no prospectus liability exists unless the relevant securities were acquired within six months from the date when the securities had

been publicly offered for the first time in Germany. The statute of limitations for prospectus liability is three years. Investors are not required to prove in litigation cases that they relied on the prospectus when investing in the relevant securities or that they still hold the securities. Further, investors also are entitled to reimbursement of their acquisition costs.

Corporate Governance. In general, the corporate action required for the issuance of securities is governed by the law of the country in which the company is incorporated. The issuance of bonds by a German issuer in the form of a stock corporation (*Aktiengesellschaft*) constitutes a management decision and, therefore, requires the approval of the management board (*Vorstand*). The articles of association (*Satzung*) may provide for the approval of the supervisory board (*Aufsichtsrat*). Bonds which provide holders with a conversion right or stock warrant (*Wandelschuldverschreibungen*) and bonds in which the rights of the holders are related to dividends paid to shareholders (*Gewinnschuldverschreibungen*) may only be issued on the basis of a resolution by the shareholders' meeting, which requires a majority of not less than three-fourths of the share capital being represented at the passing of such resolution. The articles of association may provide for a different capital majority and additional requirements. The management board may be authorised for a period of not more than five years to issue convertible bonds.

A capital increase of a stock corporation needs an amendment to the articles of association by the general shareholders' meeting (*Hauptversammlung*), and it must be registered in the Commercial Register (*Handelsregister*). Each shareholder is entitled, on demand, to subscribe to new shares in proportion to his holdings in the existing share capital (*Bezugsrecht*). Pre-emptive rights may be excluded in whole or in part only in the resolution on the share capital increase and the relevant resolution requires, in addition to the requirements prescribed by law or the articles of association for such capital increase, a majority of not less than three-fourths of the share capital being represented at the passing of such resolution. The articles of association may provide for a larger capital majority and additional requirements. In particular, the exclusion of pre-emptive rights is permitted if a capital increase against contributions in cash does not exceed 10 per cent of the share capital and the issue price is not materially below the stock exchange price.

Authorised capital (*genehmigtes Kapital*) requires a shareholders' resolution amending the articles of association, and it must not exceed 50 per cent of the existing issued and outstanding capital. The authorisation is given for a maximum period of five years from registration of the authorised capital in the commercial register. The management board is authorised to issue the new shares with the consent of the supervisory board.

The shareholders' meeting may also authorise an increase of share capital conditional on conversion rights or stock warrants obligating the stock corporation to issue new shares being exercised (contingent capital increase, or *bedingte Kapitalerhöhung*). A resolution on a contingent capital increase may be adopted only for a limited number of purposes, including the granting of conversion rights or stock warrants to holders of convertible bonds or warrant bonds. The conditional capital may not exceed 50 per cent of the existing issued and outstanding capital of the stock company.

Registration of Public Offers. It is important to emphasise that, unlike in the United States, an offer deemed public in Germany does not require registration; it only necessitates the preparation of a prospectus (see text, above).

Registration of Placements. Under German law, no registration of private placements is required.

Underwriting. Banks typically engage as underwriters for shares during the capital increase of a stock corporation, while it is less common that the newly created shares are placed in the market immediately after incorporation of a company. Under German corporate law, the term 'capital increase' means that the stated capital as registered in the Commercial Register is increased by a change of the articles of association of the relevant corporation pursuant to a shareholders' resolution to that effect. The initial placement needs, however, to be registered, but the capital increase only becomes effective on its registration in the Commercial Register.

Periodic Disclosure

Securities Listed for Official Quotation

In General. An issuer whose securities are listed on the Official Market is in particular required to inform the public and the listing office in an appropriate manner about itself and the listed securities. The specific requirements are set forth in the Exchange Admission Regulation. In particular, an issuer is required to publish the following information:

Corporate Events. The issuer of officially listed shares must publish the convening of a shareholders' meeting and information about payment of dividends, the issuance of new shares, and the exercise of conversion and subscription rights. The issuer of securities other than shares must publish the convening of a bondholders' meeting, the exercise of conversion and subscription rights, and payment of interest and redemption of principal.

Changes in the Legal Status of the Issuer. An issuer of shares admitted on the Official Market must notify the listing office of any change or amendment of its articles of association, and it must inform the listing office at the latest at the convocation of the shareholders' meeting to decide on such change or amendment. The issuer of securities other than shares must likewise inform the listing office about any intended change or amendment of its articles of association at the latest when the persons entitled to decide on such change or amendment are called.

Financial Statements. The issuer must regularly make available to the public at the paying agent its annual financial statements and, if applicable, the consolidated financial statements of the conglomerate and the report of the business situation appendixed, unless both the annual financial statement and the business report were published in Germany.

Interim Reports. At least once each fiscal year, the issuer must produce an interim report which reflects a true picture of the financial and general business situation. The interim report must facilitate an evaluation about how the business of the issuer had developed within the first six months of the fiscal year. It must contain figures about the business activities and the earnings of the issuer for that reporting period as well as explanations thereon. The figures provided in the interim report must state the turnover and the earnings before and after taxes in accordance with the applicable accounting standards. If the figures are audited by a certified accountant, the auditors' certificate, including any additional comments or restrictions or the refusal of approval, must be provided in full. The issuer must provide explanations necessary to evaluate the development of the business and earnings and must provide specific information about:

- The orders, costs, and prices of goods;
- The number of employees;
- Investments; and
- Other events of particular importance which may have an impact on the business of the issuer.

For each figure, a comparative figure for the corresponding period of time in the preceding fiscal year must be provided. If possible, the issuer must make a projection for the current fiscal year.

Additional Information. Any change of the rights conferred by the listed securities must be immediately published by the issuer. The issuer of securities other than shares must immediately publish the issuance of debt securities and the guarantees granted for them, unless there is an exemption to that effect; in respect of securities which grant their holders conversion or subscription rights, any changes to the rights conferred by the shares to which such subscription or conversion rights relate also must be published.

Regulated Market

The periodic reporting requirements for securities listed on the Regulated Market are set forth in the exchange regulations of the respective stock exchanges.

Additional Disclosure Duties. With the taking effect of the Fourth Financial Markets Promotion Act, a German stock exchange is permitted to create sub-sectors to the Official Market and Regulated Market. It may implement additional obligations arising from the admission of shares or certificates representing the shares for the purpose of the protection of the public or of an orderly trading. The Frankfurt Stock Exchange has made use of this permission and divided its Official Market and Regulated Market each into a sub-sector 'General Standard' and a sub-sector 'Prime Standard'. Admission to the Prime Standard first requires admission to the General Standard of the Official Market, respectively the Regulated Market. Such application must include all shares or certificates

representing shares of the same class admitted to the General Standard. The application may be submitted together with the application for admission to the General Standard.

Regulated Over-the-Counter Market

No particular reporting requirements apply to issuers of securities which are included in the Regulated Over-the-Counter Market.

Accounting Standards

If the issuer is a German company, it must comply with the accounting principles generally accepted in Germany. In the case of groups of companies, if the ultimate parent company is domiciled in Germany, it is required to draw up consolidated financial statements (*Konzernabschluß*) and a consolidated business report (*Konzernlagebericht*) under the German standards. However, under the recently promulgated Act for the Improvement of the Competitiveness of German Groups on the Capital Markets and for Simplification of Receiving Shareholder Loans, the ultimate German parent company is relieved from the requirement of drawing up consolidated financial statements and a business report under the German standards if it draws up consolidated financial statements and statements of affairs in accordance with internationally recognised accounting standards (ie, IAS or United States–GAAP), provided that certain further requirements are met.

Proxy Disclosure

The relevant rules for proxy voting are set forth in the Stock Corporation Act. A bank is required to obtain written proxy. It must inform the customer about how it intends to vote and is bound by the customer's instructions, if any. At the general shareholders' meeting, the credit institution must indicate that it is voting on behalf of a third party. However, it needs to disclose the identity of the relevant shareholder to safeguard its client's anonymity. Proxy voting by banks plays an important role in corporate governance since it has become a common practice for German credit institutions to exercise, for and on behalf of their clients, voting rights attached to shares kept by them in the safe custody account.

Trading Rules

Disclosure of Acquisition of Substantial Holdings

Disclosure Requirements under the Securities Trading Act. Particular disclosure requirements apply to shareholders and companies under the Securities Trading Act.

Shareholder Requirements. Sections 21 et seq of the Securities Trading Act implemented the EC Transparency Directive[27] into German law. Under section 21 of the

27 European Community Directive 88/627/EEC, 12 December 1988.

Securities Trading Act, a shareholder of a listed company is required to disclose the percentage of his shares conferring voting rights in the issuer if such shareholding reaches, exceeds, or falls below five per cent, 10 per cent, 25 per cent, 50 per cent, or 75 per cent of the voting rights by means of acquisition, disposition, or otherwise.

The shareholder must disclose this information in writing to the issuer and the BaFin without undue delay, at the latest within seven calendar days. If the entity concerned is part of a group of companies, the parent company or, if the parent company is itself a subsidiary, the latter's parent may file the information on behalf of that entity. The period commences when the person or entity concerned becomes aware or should have become aware that its voting rights have reached, exceeded, or fallen below the percentages mentioned.

Subjected to this disclosure requirement are shareholders of issuers having their place of business in Germany and whose shares are admitted to an organised Market on a domestic Stock Exchange or a Stock Exchange in a member state of the EU or EEA. Therefore, securities traded on the Regulated Over-the-Counter Market are not subject to the disclosure rules.

In order to determine whether the respective threshold has been reached, exceeded, or fallen below, the voting rights attached to the following shares are deemed as voting rights of the person concerned:

- Shares belonging to a subsidiary of the person obliged to notify;
- Shares belonging to a third person, who holds those shares for the account of the person obliged to notify;
- Shares that the person obliged to notify transferred to a third party as collateral unless the third party is entitled to exercise the voting rights of these shares and expresses the intention to exercise the voting rights independently of any directions by the person obliged to notify;
- Shares in which the person obliged to notify has been granted a right of usufruct;
- Shares which the person obliged to notify has an unconditional right to acquire; and
- Shares which are entrusted to the person obliged to notify, to the extent that it has discretion to exercise the voting rights attached to the shares if no particular directions are given by the holder of the shares.

For the attribution of voting rights, subsidiaries of the person obliged to notify are treated as equivalent to the person obliged to notify. Voting rights of the subsidiary are fully attributed to the person obliged to notify. The voting rights in the listed company held by a third purty with whom the person obliged to notify or its subsidiary co-ordinates its conduct in relation to the listed company are also fully attributed to the person obliged to notify; agreements on the exercise of voting rights on single occasions are excepted. Subsidiaries are enterprises that are subsidiaries within the meaning of section 290 of the Commercial Code or enterprises over which a controlling influence can be exercised, regardless of their legal form or their seat.

Information as to voting rights which are subject to the aforesaid rules, and are thus included in the calculation for purposes of the disclosure duties, must be separately shown in the notice to the BaFin.

On written application, the BaFin may permit voting rights to be disregarded for calculating the relevant thresholds if the applicant:

- Is a company which renders securities services and is admitted to trading on a stock exchange in a member state of the EU or EEA;
- Holds or intends to hold the shares concerned in its portfolio; and
- Demonstrates that it does not intend by means of its acquisition of the shares to exercise influence over the management of the company; or
- As far as the calculation of the five per cent threshold is concerned, (a) is a company which has its registered place of business within a member state of the EU or EEA and does not meet the requirements for the above exemptions; (b) holds or intends to hold the shares concerned to realise short-term profits through existing or expected differences between purchase and sales price; and (c) demonstrates that it does not intend through its acquisition of the shares to exercise influence over the management of the company.

Voting rights attached to shares which are disregarded for calculating the applicable threshold under the above exemptions may not be exercised if disclosure is otherwise required.

Any person who filed a notice under the foregoing rules must, on request, provide to the BaFin or the issuer evidence of its shareholding. The BaFin may further request from the shareholders and issuer of the shares information and documents necessary to monitor compliance with these disclosure duties.

Any person who intentionally or recklessly fails to properly notify the BaFin and the issuer may be fined up to €250,000. Furthermore, voting rights for which a notice is necessary must not be exercised as long as the notice is not filed.

Company Requirements. In respect of German companies, on receipt of a notification pursuant to section 21 of the Securities Trading Act, the exchange listed company must promptly, but no later than nine calendar days after receipt of such notice, publish in a national newspaper any notification designated for exchange notices. The company must thereby identify the reporting party by name and address. Moreover, the company must promptly disclose in the *Federal Gazette* the relevant newspaper in which notification had been published.

If the shares of the company are admitted to an organised market in another EU or EEA member state, it also must promptly, but no later than nine calendar days after receipt of the notice, effect publication in a newspaper which is designated for exchange notices in such country or, if the laws of such country provide for other means of informing the public, the publication must then be in the language approved for such publication in the host country.

Companies whose registered offices are located in another EU member state or another state party to the Treaty on the EEA and whose shares are admitted to an organised market not only in their home member state exchange, but also on a German exchange, must make publications required by the law in the home country pursuant to article 10 of the Transparency Directive in the German language in a German national newspaper which is designated for exchange notices.

If the proportion of voting rights held by a shareholder of a non-EU company whose shares are admitted to an organised market on a German exchange reaches, exceeds, or falls below the thresholds referred to in section 21 of the Securities Trading Act, the company is obligated to promptly publish such information and the percentage of the shareholder's voting participation but, in any event, within nine calendar days, in a national newspaper designated for exchange notices. The period begins at the time the company obtains knowledge that the shareholder's voting rights have reached, exceeded, or fallen below the specified thresholds.

Reporting Requirements under the Stock Corporation Act. The disclosure requirements of the Stock Corporation Act pertaining to the acquisition of substantial holdings do not apply if the relevant shareholder is subject to the disclosure requirements under the Securities Trading Act (ie, if the target company is listed on an organised market). Consequently, the following rules apply only if the target company is unlisted or is included in the Regulated Over-the-Counter Market. Under section 20 of the Stock Corporation Act, once a 'company' had acquired, directly or indirectly, more than 25 per cent of the shares in a domestic stock corporation ('qualified interest'), it must notify the stock corporation concerned, in writing without undue delay. The same applies if a qualified majority interest is acquired or if an interest has been increased to a majority. Likewise, a reduction of an interest below such thresholds also must be notified to that stock corporation in writing.

Although the Stock Corporation Act does not define the term 'company', it is the predominant view that any judicial or natural person who engages in business activities other than holding an interest in the relevant corporation is a 'company' provided such person pursues objectives different from those of the corporation such that the shareholders' business activity may result in a conflict of interests. The company or a dependent company is barred from exercising the membership rights (eg, voting rights) from its shareholding until these notification requirements are satisfied. Any attempt to circumvent this prohibition on the exercise of voting rights would constitute an offence subject to a fine. The stock corporation, having received a notification of qualified or majority interest, must publish such notification in the newspapers designated by the company for publication. The publication must state the name of the acquirer. The same applies to notifications of a reduction in a previously existing qualified or majority interest.

Under section 21 of the Stock Corporation Act, if a stock corporation has acquired more than 25 per cent of the shares of another domestic corporation, it must notify the other corporation in writing without undue delay. The same applies to the acquisition by the stock corporation of a qualified majority interest in another corporation. A stock corporation

which is required to notify cannot exercise its membership rights arising from the shareholding concerned until the requisite notification is effected.

Notification Obligations of Directors. Members of the management board, the supervisory body, or comparable bodies ('directors') of a company whose securities are listed on a German stock exchange must notify the purchase or sale of:

- Shares of such a company or other securities that are exchangeable for such shares or that give any other right to purchase or sell such shares; and
- A right which is not contained in the above and the price of which is directly dependent on the stock exchange price of such shares.

The director must immediately notify dealings in such securities to the related company and the BaFin. The notification must contain the specification of the security or right, the security identification number, the date of the transaction, the purchase/sale price, the number and the nominal amount of the securities or rights. The director's spouse, the director's registered partner (*eingetragene Lebenspartner*) and the director's parents and children must also notify their respective dealings in securities of the company. Non-compliance with such notification duty may be fined with up to €100,000. No notification is necessary if the purchase of securities is based on the employment relationship with the company, forms part of the director's remuneration; or if the total value of the dealings does not exceed €25,000 within a period of 30 days. The company is obliged to publish any notification forwarded to it immediately on the internet under its homepage, or in a qualifying stock exchange newspaper if the publication on the internet is too burdensome for the company. A copy of such a publication must immediately be sent to the BaFin. Non compliance with this duty can trigger a fine of up to €100,000.

Insider Trading and Fraud

In General. The BaFin supervises trading in securities. As securities services companies are required to report on a daily basis every transaction they have executed, the BaFin is in the position to identify exceptional trading volumes and price changes and to route the orders to the person who placed the order. In the event that the BaFin obtains any hint that insider trading had occurred, it may undertake further investigations on its own, in particular, it may conduct investigations at the premises of banks and brokers. The BaFin also may request that the issuer and associated companies, provided their place of business is within Germany or their securities are listed on a domestic stock exchange, disclose information about such insider information and the persons who had knowledge thereof.

Information that justifies the suspicion that insider trading was committed will be forwarded to the public prosecutor for criminal proceedings. If necessary, the BaFin will disclose all relevant information to the competent authorities of the other member states of the EU and EEA to ensure effective supervision of compliance with the insider rules. In addition, the trading supervisory department collects and monitors the trading activities

on the stock exchange floors, XETRA, and the EUREX. If it learns of suspicious trading activities, it forwards this information to the BaFin for further investigation.

Primary Insider Dealings. There are three categories of insider dealing offences for primary insiders, namely:

- Acquisition and disposition of insider securities;
- Unauthorised disclosure of insider information; and
- A recommendation to third parties.[28]

Acquisition and Disposition of Insider Securities. The insider must acquire or dispose of an 'insider security' (*Insiderpapier*). The insider must know that the relevant information of which he has knowledge is an 'insider information' (*Insidertatsache*). The insider must further 'take advantage' (*ausnutzen*) of his knowledge, which means he must make use of his knowledge in the hope and with the purpose of achieving a monetary advantage which is considered to be a violation of the principle of equal access to information for the investors in the securities markets.

Unauthorised Disclosure of Insider Information. An insider must refrain from disclosing insider information to third parties without authorisation. Furthermore, an insider must refrain from making insider information available to third parties.

Recommendations to Third Parties. It is an offence for an insider to recommend a third party to deal in insider securities on the basis of insider information. The third party does not need to know that the recommendation is based on an insider information and it is irrelevant how the tipper obtained his inside knowledge. It suffices that the recommendation is made on the basis of the tipper's knowledge of the insider information.

Secondary Insider Dealings. It is an offence for any person who is not a 'primary insider' to take advantage of his knowledge of an insider information by acquiring or disposing insider securities for his own account or the account of, or on behalf of, another person. The source of knowledge is irrelevant and no particular relationship is required between such person and the issuer. However, the person must have been aware that the information is an insider information and must act with the intention of achieving a monetary advantage by taking advantage of such information. If a person had learned of an insider information and discloses or makes this information available to another person, such person could be held guilty of solicitation or of aiding and abetting insider trading.

'Primary Insiders' and 'Secondary Insiders'. 'Primary insiders' are persons who have a close relation to the issuer by reason of their:

- Position with the issuer;

28 Securities Trading Act, ss 12 *et seq*.

- Having an interest in the issuer; or
- Special (contractual) relationship to the issuer.

In contrast, secondary insiders are persons who have no particular relationship to the issuer other than having insider knowledge. The first category of primary insiders comprises any person who is a member of the managing or supervisory board or a personally liable partner, either of the issuer or an associated company. The second category of primary insiders comprises any person who has an equity interest in the issuer or in an associated company. The third category of primary insiders comprises persons who have knowledge of insider information relating to one or more issuers of insider securities through their profession or work, and the learning of such insider information is related specifically to the scope of such profession or work. This category of insiders typically comprises professional advisers, such as accountants, lawyers, management consultants, and their employees. Any other person who learns of insider information is a secondary insider.

'Insider Securities'. 'Insider securities' are securities which are:

- Listed on a German stock exchange;
- Included in the Regulated Market or in the Regulated Over-the-Counter Market of a German stock exchange; or
- Listed on the organised market of another member state of the EU or EEA.

The term includes:

- Rights to subscribe to or sell or buy securities;
- Rights to receive payment of the difference which depends on the price of securities futures contracts on a stock or bond index or interest rate futures contracts ('financial futures contracts');
- Rights to subscribe to or buy or sell financial futures contracts if such financial futures contracts are related to securities or an index that is, at least partly, based on the price of securities; and
- Rights to any other futures contracts that obligate the parties to buy or sell securities.

Such rights or futures contracts must be listed on an organised market within a member state of the EU or the EAA and the underlying securities that are subject to such rights, and the futures contracts must themselves be listed on such a market or be included in the Regulated Market or in the Regulated Over-the-Counter Market. In addition, the term 'insider securities' includes securities which have not yet been listed but whose application for listing has been either filed or publicly announced.

'Insider Information'. The term 'insider information' is defined as information that is not publicly known and relates to one or more issuers of insider securities or to insider

securities which, if it becomes publicly known, would be apt to influence significantly the price of such insider securities.

Criminal Offence Provision. Pursuant to the Securities Trading Act, insider offences may be punished by imprisonment for a term of up to five years or by a fine. The actual punishment imposed depends, among other things, on the personal wealth and the grade of fault of the offender. No distinction is made between primary insiders and secondary insiders with regard to the limits on punishment. However, the latter might be treated more leniently. The insider rules are not applicable to transactions that are executed for monetary, currency, or debt policy reasons by the federal government, one of the government's special asset facilities, a German state, the Bundesbank, a foreign country or its central bank, or an organisation or persons retained for that purpose.

Immediate Disclosure

In General

Section 15 of the Securities Trading Act provides that the issuer of securities which are listed on a German stock exchange must, without undue delay, disclose (*Ad hoc-Publizität*) any new information that has emerged within its sphere and which is not publicly known if such new information is apt to significantly influence the price of the securities because of its effect on the assets or the financial or general business situation of the issuer. If the issuer has debt securities outstanding, the issuer has a duty to disclose any new information that may adversely affect its ability to fulfil its obligations thereunder. The publication must be in German, the issuer must be the author of the publication and a reader must be able to identify the issuer as the author. Characteristic financial figures used in the publication must be common to ordinary business transactions and must allow a comparison to figures used in the previous publications. Other information that does not meet the requirements of *ad hoc* disclosure (eg, advertisement) may not be included in the publication. Untrue information must be immediately corrected by way of a publication pursuant to Section 15 of the Securities Trading Act. The BaFin may, upon request, allow issuers with their principal place of business outside Germany to publish the information in another language provided that sufficient information of the public is ensured.

The Frankfurt Stock Exchange, together with the BaFin, have prepared a guide in which the terms of section 15 of the Securities Trading Act are interpreted by the Stock Exchanges.

'Information'

The term 'information' is undefined. The information must be 'new'. Reports in the economic print media or news agencies which are published by the press and which do not contain mere suspicions or rumours, but factual information, relieve the issuer from its duty to disclose. Therefore, information that is already known to the public does not need to be published in the manner prescribed. The information must be related to, and must have occurred within, the sphere of the issuer. Hence, the term 'insider information' has a

broader meaning than information which is subject to the immediate disclosure rules, since insider information also may originate outside the issuer's sphere.

The information also must have an impact on the issuer's assets or financial situation or general business. The Financial Committee of the Bundestag stated that the terms 'assets' and 'financial situation' are to be interpreted in accordance with German accounting rules, which provide that the annual financial statement must represent a true and correct picture of the assets, the financial situation, as well as a description of the overall situation and the business of the company. Hence, information would have an impact on the assets or financial situation if, in accordance with the principles of orderly bookkeeping, such information would cause at least an entry reflected in the annual financial statements or were to be included in the management report. Events whose consequences cannot be determined because the effects of such events could be offset or compensated by other circumstances or by positive countermeasures of the issuer are not 'information' within the meaning of section 15 of the Securities Trading Act.

The question of whether 'information' had actually occurred is particularly significant for internal decision-making processes that consist of several steps, in particular when the managing board's decision requires the approval of the supervisory board.

Likelihood to Significantly Influence Price of the Securities

The information must be likely to change significantly the price of the securities by reason of its impact on the assets or financial or business situation of the issuer. Whether information is likely to influence significantly the price of the security depends on the general life experience; the issuer, in cases of doubt, should obtain professional advice. This suggestion is of no assistance in applying the law but, if a market professional opines that certain information would not be significant, the issuer might have a valid defence in legal proceedings since sanctions for violation of the disclosure duty require recklessness or intent.

If new information with the potential to influence the exchange price (eg, a material gain or loss) results from one incident, this information must be disclosed without undue delay on its occurrence. If isolated incidents, which themselves do not have the potential to materially influence the exchange price, are aggregated in the annual or interim reports, the result of this aggregation may be information with the potential to materially influence the exchange price. In this case, such result must be disclosed under the immediate disclosure rules. Information so disclosed occurs as soon as the results of the aggregation are known to the management board or any person otherwise responsible for disclosure by the company pursuant to section 15 of the Securities Trading Act. This means that, if information having the potential to influence the exchange price is included in an annual report, the information occurs at the latest on the management board having drawn up the annual report. For purposes of reporting pursuant to section 15 of the Securities Trading Act, only information having the potential to influence the exchange price needs to be disclosed, ie, not the entire annual or interim report which contains such information.

Application to BaFin for Exemption

On application, the BaFin may exempt the issuer from its duty to disclose information if the issuer can demonstrate that disclosure is likely to damage its legitimate interests. If such application was filed without undue delay on emergence of information which would otherwise trigger public disclosure, the issuer does not violate its duty to disclose, even if the application is subsequently withdrawn. In the past, the BaFin has granted exemptions (eg, when there were promising reorganisation plans to prevent imminent insolvency which would apparently be jeopardised by early immediate disclosure).

On application, the BaFin may exempt foreign issuers from the requirement to disclose a new fact to the relevant stock exchange and the BaFin prior to making the requisite publication of such fact, provided that such exemption does not negatively affect the examination by the managing board of the relevant stock exchange as to whether trading in the relevant securities should be suspended. If such exemption is granted, the publication and the notification of the stock exchange and the BaFin may be effected by the foreign issuer simultaneously.

Steps and Timing of Immediate Disclosure

Disclosure of Information to BaFin and Stock Exchanges. Prior to the publication, the issuer must disclose the information to the BaFin and the managing board of the stock exchange where the securities are listed. The purpose of the latter requirement is to allow the managing board of the relevant stock exchange to examine whether trading in the securities should be suspended. If trading in the securities is suspended, all unexecuted orders will be deleted. The managing board of the respective stock exchange requires some time to make inquiries prior to its decision as to whether suspension of trading is appropriate. Once made, the publication of the new fact must be forwarded to the BaFin and the managing board of the respective stock exchange.

In any event, disclosure must be made without undue delay. 'Without undue delay' means without negligent or intentional hesitation. The issuer has time to carefully examine the effects of an event to determine whether there is a duty to disclose. On the other hand, since the likelihood of influencing the price is a crucial element, time for review is more restricted.

Publication. The issuer must publish the information in a regional mandatory exchange journal or in an electronic information system that is widely used by the market participants. The reason for this requirement is not only to ensure broad dissemination, but also to control the dissemination before timely publication occurs. Hence, a press release prior to the publication in the above manner would be a violation of section 15 of the Securities Trading Act. The issuer must be the author of the publication, and a reader must be able to identify the issuer as author. The issuer is responsible for ensuring that all relevant information is published without any changes.

The BaFin may exempt the issuer from this requirement in that the issuer may publish the information in summary form if complete information is available at the paying

agent of the issuer and a notice to that effect is given. Because the stock exchange board may only make use of the information to determine whether trading should be suspended, the issuer must forward the information separately to the electronic information system provider to he stock exchange if it wants to disseminate the information via such electronic system.

Submission of Notice of Publication to BaFin and Stock Exchanges. The issuer must, without undue delay, submit a notice to the BaFin and the stock exchanges that the prescribed publication has been made.

Publication in the Federal Gazette. A notice must be published in the *Federal Gazette* about where the publication was made or where the publication may be obtained.

Language for Publication and Disclosure. Publications and disclosure of German issuers must be furnished in the German language and may be made simultaneously in English. Publications and disclosure of foreign issuers having their seat abroad may be made in English.

Sanctions. Pursuant to the Securities Trading Act, violations of the disclosure requirements may attract a fine of up to €1.5 million, provided the issuer acted with intent or was reckless. Representatives of the issuer also can be personally liable to sanctions. In addition, if the disclosure was omitted with the intent of influencing the price, the responsible person may be imprisoned for a term of up to three years, pursuant to the Securities Trading Act.

Pursuant to section 37 b of the Securities Trading Act, investors may claim damage from an issuer who has omitted the immediate disclosure of new facts pursuant to section 15 of the Securities Trading Act. Such a claim requires that the respective investor acquired the securities:

- After the omission and still held the securities at the time when the fact became public; or
- Before the occurrence of the new fact and sold the securities after the omission.

Pursuant to section 37c of the Securities Trading Act, an investor may claim damage from an issuer who has published untrue information in a publication pursuant to section 15 of the Securities Trading Act, if the respective investor acquired the securities:

- After the publication of the untrue information and still held the securities at the time when the inaccuracy of the information became public; or
- Before the publication of the untrue information and sold them before the inaccuracy of the information became public.

Public Take-Over Bids

General

Upon failure of the EC Directive on Take-over Offers in summer 2001, the German legislature implemented the Act to Regulate Public Tender Offers for the Purchase of Securities and Company Take-overs (the 'Take-over Act') on 1 January 2002. Before the coming into force of the Take-over Act, take-overs in Germany were regulated by the Take-over Codex, a voluntary regulation comparable with London's City Code on Take-over and Mergers.

Main Principles

Pursuant to the German legislature the Take-over Act provides for a fair and regulated procedure for public take-over offers in Germany, without preventing or promoting take-over offers. The main principles for such a procedure are:

- The obligation of the bidder to treat all shareholders equally under the same conditions;
- The obligation of the bidder to provide the shareholders with substantial information; and
- The obligation of the bidder to guarantee the financing of the offer.

Applicability

The Take-over Act is applicable to public offers by bidders to buy securities of a target company. Any natural or legal person may be a bidder. Companies qualify as target companies under the Take-over Act if their registered seat is in Germany and if their securities are listed on an organised market within the EU.

The Take-over Act distinguishes among three different kinds of offers:

- Mandatory offers which are required by law after the gaining of control over a target company (the 'Mandatory Offer'); a bidder is deemed to have gained control over a target company if the bidder acquired an interest in the target company of at least 30 per cent;
- Voluntary offers which are aimed at gaining control over a target company (the 'Take-over Offer'); and
- Voluntary offers which are not aimed at gaining control over a target company, ie, aimed at the acquisition of less than a 30 per cent interest in the target company (the 'Public Offer').

Contribution

The contribution offered by the bidder to the shareholders of the target company must consist of cash or shares tradable on an organised market within the EU or a mixture of both. Additional contributions of other kinds (such as non-tradable shares) are permitted. In case of a public offer, the contribution may be made in any other way. The calculation

of the contribution is substantially based on the average stock exchange price of the target company's securities during the three months previous to the offer. The contribution will be adjusted to any higher price paid or promised by the bidder (or related parties) for securities of the target company during the offer period or within one year after the termination of the offer period.

Main Obligations of Bidder and Target Company

Once the bidder has taken the decision to make a public offer, it must immediately publish its decision. The take-over offer made by the bidder must be binding. It may be subject to certain conditions, unless such conditions can be influenced by the bidder. The bidder is required to publish an offer document which contains all material information on the take-over offer within four weeks from the time of publication of its decision to make a public offer. During and after the take-over offer period the bidder must publish the amount of voting rights held by it. The managing board and the supervisory board of the target company are obliged to publish a comment on the take-over offer immediately after the publication of the offer document.

After the publication of the decision to make a take-over offer, the management board of the target company is substantially prohibited from taking defence measures which may prevent the success of the take-over offer. However, the general shareholders' meeting may authorise the management board before the publication of a decision to make a public offer to take defence measures in order to prevent a successful take-over. Such authorisation may be granted for a maximum of 18 months. Further, the managing board is entitled to take actions against a public take-over offer which have been approved by the supervisory board of the target company.

Squeeze-Out. Pursuant to the German Stock Exchange Act, a majority shareholder is given the possibility to squeeze out minority shareholders against a contribution in cash. In order to make use of this provision, the majority shareholder must hold an interest of at least 95 per cent in the target company.

Greece

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Greece

Panos Koromantzos
Bahas, Gramatidis & Partners
Athens, Greece

Introduction

Securities

Securities are broadly categorized as:

- Debt securities, such as banknotes, bonds, and debentures;
- Equity securities, such as common stocks' shares; and
- Derivative contracts, such as forwards, futures, options, and swaps.

According to Greek legislation, the most common types of securities are the following:

- Securities to the bearer;
- Registered securities; and
- Securities payable to order.

Types of securities were enriched by virtue of Law Number 2651/1998, with any exchangeable value defined as security by decision of the Capital Market Commission. Securities are regulated by various legislative documents, which include certain articles of the Civil Code (especially articles 888–900), the Commercial Code, Law Number 5325/1932 on bills of exchange and promissory notes payable to order, Law Number 5960/1933 on bank checks, Law Number 2190/1920 on companies limited by shares, and Legislative Decree of 17 July/13 August 1923 on special provisions for companies limited by shares.

Athens Stock Exchange

The Athens Stock Exchange (*Chrimatistirio Athinon)* was initially a public legal entity of the Hellenic State. By virtue of Law Number 2324/1995, it became a company limited by shares, with sole shareholder being the Hellenic State. In 2000 a company's shares were transferred to a holding company, within which the Hellenic State participates with approximately 33.4 per cent and whose shares are listed with the Athens Stock Exchange.

The basic legislative framework regarding the Athens Stock Exchange includes Law Number 3632/1928, Law Number 350/1985, Law Number 1806/1988, Presidential Decree Number 51/1992, Law Number 2188/1994, Law Number 2324/1995, Law Number 2533/1997, Law Number 2651/1998, Law Number 2733/1999, Law Number 2842/2000, Law Number 2892/2001, Law Number 3152/2003, Law Number 3283/2004, Law Number 3371/2005, Law Number 3556/2007, Law Number 3606/2007, Law Number 4141/2013, and the Athens Stock Exchange Regulation (amended by Decision ASE BoD of 9 May 2013). Relevant substantial dispositions also are provided by Ministerial Decisions, Resolutions of the Board of Directors of the Athens Stock Exchange, Decisions of the Capital Market Commission, and European Union (EU) legislation.

In addition, the application of International Financial Reporting Standards to listed companies, introduced by Law Number 3229/2004, has offered coherence and has facilitated the function of the Athens Stock Exchange, enabling the better information of the investors.

The Ministry of Economy and Finance, the Board of Directors of the Athens Stock Exchange SA, and the Hellenic Capital Market Commission are the authorities that supervise the operation of the Athens Stock Exchange. The Hellenic Capital Market Commission is a public legal entity operating under the supervision of the Ministry of Economy and Finance and holds a significant institutional and operational role.

Types of Securities on Athens Stock Exchange

In General

Shares, bonds,[1] and Hellenic certificates (ELPIS)[2] are considered as the most common securities marketed in the Athens Stock Exchange. In all cases, it is imperative that all shares and bonds listed with the Athens Stock Exchange be dematerialized.

Registered Shares – Shares to the Bearer

Registered shares bear the name and other particulars of their beneficiary holder and are registered with the Shareholders' Register. Any company may issue registered shares, provided that such possibility is stipulated in its statutes.

For certain categories of companies, such as banking institutes and insurance companies, the issuance of registered shares is obligatory. This type of share is

1 Securities listed with the Athens Stock Exchange are mainly shares and bonds belonging to Greek and foreign companies (under the condition that they are listed with their national stock exchange), bonds, promissory notes, and treasury bills issued by the Hellenic State, and foreign states.

2 This type of securities refers to foreign shares (and not domestic shares) that a bank has by virtue of a relevant contract with a foreign company (the issuer of the shares). The bank administers or allots the shares on behalf of the foreign issuer. The Hellenic Capital Market Commission's permission is necessary.

transferable by endorsement of the central securities depository titles and registration with the Shareholders' Register. Shares to the bearer are the most common type of shares of the Greek companies. Such shares are transferred by simple handing over.

Common Shares – Privileged Shares

Common shares certify that their owner is associated with the company according to the percentage of the owner's shares. These shares entitle their owner to participate in the company's profits and to vote in the shareholders' general assembly in matters such as the election of the board of directors and amendment of the balance sheet.

Privileged shares offer their owner further rights, among which usually falls the right (privilege) to take a dividend even when there are no profits. Such shares may be issued with or without a voting right. In principle, in Greece, privileged shares are usually issued without a voting right. Law Number 876/1979 on the Development of the Capital Market limits the issuance of privileged without voting right shares, to 40 per cent of the company's capital. However, companies may issue convertibles without the above-mentioned limitation, i.e., privileged shares that may be converted into common shares, the time of conversion already having been defined.

Admission to Athens Stock Exchange

In General

The Athens Stock Exchange operates a Primary Market with two separate markets, the Securities Market and the Derivatives Market. Additionally, the Athens Stock Exchange operates the Alternative Market as a Secondary Market.

The Securities Market is a regulated market operating since 2002 and supervised by the Hellenic Capital Market Committee. In this market, mainly securities, preemption rights to acquire securities, bonds, and Hellenic Certificates are marketed. The Derivatives Market is a regulated market operating since 1999 and is supervised by the Capital Market Committee. Within the Derivatives Market, any financial instrument, including derivatives, future contracts, options, and repos, may be marketed.

The Alternative Market is a multilateral trading facility as provided by European Directive 2004/39/EC, operated by the Athens Stock Exchange and supervised by the Hellenic Capital Market Commission. The Athens Stock Exchange transactions take place during its regular session, with or without the participation of a member (in-market or off-market transaction). Furthermore, transactions may be concluded without participating in the session (transaction by counterbalancing entry). Under Greek legislation, it is possible for foreign companies to become listed, provided specific legal requirements are met that pertain to the company itself and/or its shares. The admission to a market of the

Athens Stock Exchange is regulated by its regulation in force and Law Number 3371/2005.

Requirements

Type of Company

Admissible to apply for listing with the Athens Stock Exchange are companies limited by shares (*société anonyme*, *anonymi etaireia*).

Minimum Equity

Admissible companies must have a minimum equity of €3,000,000.

Financial Statements

The applicant company must have published or submitted for publishing its annual financial statements for at least the three years prior to its application for listing with the Athens Stock Exchange. The statements must have been audited by a chartered accountant.

According to the law, it is required that the applicant company's last balance sheet show satisfactory operating results and assets. The Athens Stock Exchange Regulation indicates that the applicant's financial statements must be free of remarks that may have a negative effect on the company's real financial status. However, the Hellenic Capital Market Commission, following an opinion of the Athens Stock Exchange Board of Directors, may exceptionally permit a company to become listed, even if it has been operating for less than three years. Such exception is possible if the listing is considered to be in favor of the applicant company or the investors and sufficient information has been given to them.

Distribution of Shares

An applicant's company shares must be sufficiently distributed to the public. A distribution is considered to be sufficient if at least 25 per cent of the shares to become listed are distributed to the public.

In any case, sufficient distribution is accomplished if the shares to become listed are owned by at least 300 persons, among which none holds more than five per cent of the totality of the shares proposed for listing. Shares may become exceptionally listed with the Athens Stock Exchange even without the required distribution if at least five per cent of the totality of the shares to become listed are distributed. The following persons are exempted from the calculation of a sufficient distribution:

- Members of the board of directors of the applicant company;
- Managers and personnel of the applicant company;

- Relatives of first degree of kinship of major shareholders and managing personnel;
- Suppliers or persons collaborating with the company; and
- Existing shareholders who acquired shares within the last year prior to the company's application, unless they are institutional investors or business-sharing companies (*etairies epichirimatikon symmetochon*).

If the applicant company has shares already listed and negotiated with a stock exchange of one or more member states of the European Union, or of a third country, the distribution of its shares in those markets will be taken into consideration when calculating the distribution for the listing with the Athens Stock Exchange. However, it is necessary for the company to secure a minimum distribution within Greece, regarding both the percentage of the capital and the number of the shareholders.

Tax Audit

The applicant company must have undergone a thorough tax audit covering all financial years prior to the filing of the application. If the applicant company is subject to consolidated financial statements, tax audit covers all integrated companies. If the company subject to tax audit has its headquarters abroad, tax audits must be performed by an international accounting firm.

Special Advisor

The applicant company must appoint a member of the Athens Stock Exchange as its special sponsor advisor. Among the sponsor advisor's duties are the promotion of the newly listed company to investors of the Athens Stock Exchange. The sponsor advisor issues an analysis of the new listed company upon the completion of a 12-month period of listing with the Athens Stock Exchange.

Special Requirements According to Company's Field of Operation

For companies operating in the sector of insurance, construction, or trade of automobiles, special provisions on the requirements of tax audit and their financial status apply.

Admission Cost

Companies to be listed for the first time are subject to a registration fee proportional to the value of the shares to become listed. The value of the shares to become listed is the product of the number of the shares to become listed and the value at which they will become listed. The registration fee amounts to 0.08 per cent for shares having a total value up to €1,500,000,000, and it decreases to 0.04 per cent for a value exceeding the €1,500,000,000 and up to €3,000,000,000, and to 0.02 per cent for a value exceeding the €3,000,000,000. In any case, the minimum registration fee is €10,000.

Listed companies must pay to the Athens Stock Exchange a quarterly subscription, which varies from €1,000 to €8,000, according to the average value that the listed shares had during the month preceding the month within which the subscription is due.

International Accounting and International Financial Reporting Standards

In General

Pursuant to Law Number 2190/1920, the fundamental legislative text for limited liability companies, as amended and in force, and Law Number 3229/2004, companies (including parent companies) having shares or other securities listed are obliged to draft their financial statements in accordance with the International Accounting Standards International Financial Reporting Standards.

The obligation extends to the financial statements of the associated companies to a parent company that reside in Greece or abroad, provided that the respective national legislation provides for the application of the International Accounting Standards International Financial Reporting Standards. Non-listed companies also may adopt the International Accounting Standards International Financial Reporting Standards.

Information Obligations

Information before Listing

A company addressing an invitation to the public, or which is going to become listed with the Athens Stock Exchange, shall issue an informative prospectus pursuant to Presidential Decree Number 350/1985, Law Number 2651/1998, Law Number 3371/2005, Law Number 3401/2005, Directive 2003/71/EC, and Directive 2010/73/EU. The informative prospectus is subject to the approval of the Hellenic Capital Market Commission.

The prospectus must be complete, true, accurate and not misleading to the public. The prospectus must include data as to the features and characteristics of the applicant company and the securities intended to become listed. Abovementioned legislation specifies the content and the pattern of the prospectus. The prospectus should contain information on the persons being responsible for its issuance and its content, on the securities that are going to become listed, on the issuing company, including its capital, activities, property, financial status, and results, and information on the administration, management, supervision and auditing, and possibly on its business plans.

The prospectus is subject to the approval of the Hellenic Capital Market Commission. The Hellenic Capital Market Commission may opt for the partial or entire exemption from disclosing certain information as an exception, such as where the securities are shares given for free to beneficiaries of shares already listed on the Stock Exchange or securities that were the object of public offering

or that are listed with a Stock Exchange of another EU member state. Furthermore, the Hellenic Capital Market Commission may permit the applicant company to not disclose certain information, should it consider that such information is insignificant and not able to influence the evaluation of the company's financial status and results, or contradicts, public interest or such that may cause a serious damage to the company (under the condition that such 'concealment' is not likely to mislead the public as to facts and circumstances important for evaluating the securities).

Information following Listing

Regulation of the Athens Stock Exchange provides the obligation for listed companies of periodic and unscheduled disclosure of information. Periodic disclosure has the meaning of provision of information on a company's financial status on a regular basis, being an annual, six-month, and three-month basis.

Listed companies are obliged to provide information regarding events that affect the company, such as general meetings to be convened, distribution and payment of dividends, issuance of new shares, acquisition and transfer of significant participation to a company's shareholding structure and, in general, events important for the company which are not otherwise accessible to the public and may affect the company's financial situation or the course of its operations. Provided that certain requirements are met, a company may be exempted from its obligation for the provision of certain information, if such disclosure is likely to cause serious damage to the company.

Supervision

In general, the rules of the International Organization of Securities Commissions are observed in Greece. Moreover, the Hellenic Capital Market Commission is a member of the International Organization of Securities Com missions. On a national level, supervision of the securities market is exercised by:

- The Ministry of Finance;
- The Hellenic Capital Market Commission;
- The Board of Directors of the Athens Stock Exchange; and
- The Athens Stock Exchange's members themselves, who must abide by the Stock Exchange Code of Ethics and comply with the Athens Stock Exchange Regulation.

Corporate Governance

Corporate governance issues are regulated by Law Number 3016/2002, which encompasses limited liability companies that follow a procedure to list or have already listed their shares or other securities with organized stock exchanges.

It is forbidden for a member of a listed company's board of directors or any third person entrusted with relevant duties to pursue interests that contravene the

company's interests. Such persons should disclose potential or existing conflicts of interests to other members of the board. The obligations also cover the applicant or listed company's affiliated companies, as those are defined in Law Number 2190/1920. Unless minority shareholders' representatives participate on the board of directors, it is essential that at least two of the board's non-executive members be independent. Members are considered independent when:

- They do not have a professional or business relationship with the company, or any associated company, which may affect the company's activity;
- They are not the chairman of the board or managers of the company itself or of its affiliated companies; and
- They are connected to the company or to an affiliated by virtue of dependent employment or stipendiary mandate.

During their term with the board, independent members are not allowed to own shares exceeding 0.5 per cent of the company's total share capital. The existence of an internal operating regulation is a prerequisite for a company to become listed with the Athens Stock Exchange. The internal operating regulation is drafted by the company's board of directors, and must include the structure of the company's services, their objects, and the relationship between the services and the administration; the definition of the duties of the board (executive and non-executive members); the procedures for employing and evaluating managers; the monitoring procedures for transactions performed by the members of the board, the company's managers, and any other party who may have had access to internal information on securities, as a result of the person's relationship with the company; the procedures for announcing to the public major transactions; and the rules governing transactions between associated companies, the monitoring of transactions, and their timely disclosure to the company's organs and shareholders.

Moreover, it is required that the company has a completely independent internal audit department. Internal auditors must be independent, in the sense that, under no circumstances may members of the board, managers, or their close relatives become company's auditors.

National Treatment and Reciprocity

Listing of foreign companies with the Athens Stock Exchange is possible and, in principle, they fall under the same restrictions and have the same rights and obligations as Greek companies. A significant role is reserved to the legislation of the state of 'origin' of the foreign company.

The applicant foreign company should indicate in its application whether it has already filed an application with the Stock Exchange of another EU member state or intends to do so in the near future. In such cases, authorities of the EU member states shall cooperate. For instance, if the prospectus of a company having its seat in one of the EU member states has already been approved by the

competent authority abroad, the Hellenic Capital Market Commission shall also in principle accept that approval for its own purposes.

In general, the authorities of both countries must exchange any information necessary for the acceleration of the admission procedure. Nevertheless, the Athens Stock Exchange is often cautious in disclosing information concerning the applicant company, since such information is protected by the principle of confidentiality.

Hong Kong

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Hong Kong

Kingsley T W Ong
Eversheds
Hong Kong
and
Eugene Y C Yeung
Mayer Brown JSM
Hong Kong[1]

Introduction

In General

Hong Kong has consistently been ranked as one of the top international financial centres in the world,[2] and is known to be amongst the world's freest economies.[3] Hong Kong prides itself in a market policy of minimum intervention in the way in which the market operates.

On 1 July 1997, Hong Kong reverted to Chinese sovereignty and became the Hong Kong Special Administrative Region (HKSAR) of the People's Republic of China (PRC). The concept of a *laissez faire* free market is so important in Hong Kong that it is constitutionally enshrined in the Hong Kong Basic Law.[4]

Shortly after reversion to Chinese rule, Hong Kong was severely affected by the 1997 Asian financial crisis. During the Asian financial crisis, several brokerage firms collapsed (for example, CA Pacific Group and the Peregrine Group) resulting in significant client losses. Hong Kong, like much of Asia, also

1 All views expressed in this chapter are those of the authors alone. The law is stated as at 1 September 2013.

2 'Hong Kong joins NY, London as top finance centre', 19 September 2010, Agence France-Presse.

3 The Heritage Foundation has voted Hong Kong as the world's freest economy for the past 16 years (1995–2010).

4 Article 112 of the Hong Kong Basic Law provides: 'No foreign exchange control policies shall be applied in the Hong Kong Special Administrative Region. The Hong Kong dollar shall be freely convertible. Markets for foreign exchange, gold, securities, futures and the like shall continue. The Government of the Hong Kong Special Administrative Region shall safeguard the free flow of capital within, into and out of the Region'. The Hong Kong Basic Law is the constitutional document of Hong Kong. It was adopted on 4 April 1990 by the Seventh National People's Congress (NPC) of the PRC, and went into effect on 1 July 1997.

experienced extraordinary turmoil in the currency, securities and futures market, which the Hong Kong Government attributed to hedge funds speculating against the Hong Kong dollar link to the United States dollar. The extraordinary events of the Asian financial crisis highlighted the need for Hong Kong to upgrade its legislative framework for securities and futures market regulation. Against this background, the Securities and Futures Ordinance was implemented in 2003.

One decade later, in September 2008, the global financial system experienced its first systemic crisis since the Great Depression of 1930 following the collapse of Lehman Brothers. Significant interventions by the governments in the United States of America and Europe have so far avoided a global financial system collapse.

However, the full impact of the 2008 global financial crisis is yet to be determined, and, coupled with the Eurozone debt crisis, financial and economic developments are still unfolding. Although Hong Kong was not at the epicentre of this crisis, it has nonetheless been affected.[5] This chapter is written at a time when further reforms are being proposed and implemented in the Hong Kong securities industry to address the challenges from this ongoing global financial crisis. It remains to be seen how extensive the changes instituted will be.

Regulatory System

The Financial Services Branch of the Financial Services and the Treasury Bureau of the Hong Kong Government is charged with the responsibility to maintain and enhance Hong Kong's status as a major international financial centre. It is tasked to ensure that Hong Kong's markets remain open, fair and efficient. While market regulatory functions are performed by independent statutory regulators, the Financial Services Branch facilitates and co-ordinates initiatives to upgrade overall market quality and to ensure that Hong Kong's regulatory regime meets the needs of the ever-changing financial market.[6]

The principal independent statutory regulators are the Securities and Futures Commission (SFC), the Hong Kong Monetary Authority (HKMA), the Office of the Commissioner of Insurance and the Mandatory Provident Fund Schemes Authority. They are responsible, respectively, for the regulation of securities and futures, banking, insurance and retirement scheme industries. The Securities and Futures Ordinance (SFO) is the principal legislation in Hong Kong regulating securities, futures and leveraged foreign exchange contracts, intermediaries and markets of Hong Kong.[7]

5 Examples include a run on Bank of East Asia (late September 2008), panicked policyholders following the US bailout of AIG, the Lehman minibonds fallout (where retail investors in structured investment products linked to Lehman Brothers suffered significant losses), and CITIC Pacific's HK $15.5 billion foreign exchange losses on leveraged structured foreign exchange derivatives (disclosed on 20 October 2008).

6 See website of the Financial Services Branch of the Financial Services and the Treasury Bureau of the Hong Kong Government: www.fstb.gov.hk/fsb.

7 Before the Securities and Futures Ordinance became law, Hong Kong's securities and

Authorities

Securities and Futures Commission

The SFC is an independent, non-governmental statutory body outside the civil service responsible for regulating the securities and futures market in Hong Kong. It was established in May 1989 following the enactment of the Securities and Futures Commission Ordinance (Cap 24).[8] Its regulatory functions and powers were expanded in 2003 when the SFO was implemented. Under the SFO, the SFC has six statutory regulatory objectives to:[9]

- Maintain and promote fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- Promote understanding by the public of the operation and functioning of the securities and futures industry;
- Provide protection for members of the public investing in or holding financial products;
- Minimise crime and misconduct in the securities and futures industry;
- Reduce systemic risks in the securities and futures industry; and
- Assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

In achieving these objectives, the SFC supervises three main groups of participants in the securities market in Hong Kong, namely:[10]

- Intermediaries — brokers, investment advisers, asset managers and investment bankers who are engaged in regulated activities;
- Issuers of securities — listed companies and investment funds through an authorisation process to ensure that adequate and unbiased information is available to permit informed investment decisions; and
- Market operators — providers of trading platforms of securities, for example, HKEx, which is the holding company of the stock exchange, the futures exchange and the securities clearing company.

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futures laws were spread over 10 Ordinances, namely: Securities and Futures Commission Ordinance (Cap 24), Commodities Trading Ordinance (Cap 250), Securities Ordinance (Cap 333), Protection of Investors Ordinance (Cap 335), Stock Exchange Unification Ordinance (Cap 361), Securities (Insider Dealing) Ordinance (Cap 395), Securities (Disclosure of Interests) Ordinance (Cap 396), Securities and Futures (Clearing Houses) Ordinance (Cap 420), Leveraged Foreign Exchange Trading Ordinance (Cap 451), Exchanges and Clearing Houses (Merger) Ordinance (Cap 555), and parts of the Companies Ordinance (Cap 32).

8 The Securities and Futures Commission Ordinance was repealed in 2003.

9 Securities and Futures Ordinance, s 4.

10 Securities and Futures Commission 2008/09 annual report, p 9.

Hong Kong Exchange

The Hong Kong Exchanges and Clearing Limited (HKEx) was formed on 6 March 2000 by a merger of its three main constituent companies, namely, the Stock Exchange of Hong Kong Limited (SEHK),[11] Hong Kong Futures Exchange Limited (HKFE)[12] and Hong Kong Securities Clearing Company Limited.[13] The SFO allows the SFC to recognise a company as an exchange company. The recognition will be given where the SFC is satisfied that to do so is in the public interest or necessary for the purposes of proper regulation of the markets in securities and future contracts.[14]

When a company becomes a recognised exchange company, the SFC must publish notice of that fact in the *Gazette*.[15] The SEHK and HKFE are currently the only two recognised exchange companies in Hong Kong. Both are deemed to be recognised exchange companies under section 19(2) of the SFO by virtue of section 5(a), Part 1 of Schedule 10 of the SFO.[16] The duties of the recognised exchange companies are to:

- Ensure an orderly, informed and fair market, to operate its facilities in accordance with the rules approved by the SFC;[17]
- Formulate and implement appropriate procedures for ensuring that its exchange participants comply with its rules;[18]
- Notify the SFC in relation to compliance by its exchange participants;[19] and

11 As at 19 July 2012, Hong Kong's stock market was the seventh largest in the world and the third largest in Asia in terms of market capitalisation. There were 1344 companies listed in the SEHK, with a market capitalisation of US $2,376 billion. Among them, 700 were PRC Mainland enterprises which have together raised around HK$ 2,618 billion from 1993 to the end of July 2012. (Source: WFE, HKSE).

12 The HKFE is a trading platform for the derivatives market in Hong Kong. As at the end of July 2012, five types of futures products and two types of options products were traded on the HKFE or SEHK, including index futures, stock futures, RMB currency futures, interest rate futures, bond futures, gold futures, index options and stock options.

13 Hong Kong Exchanges and Clearing Limited (HKEx) is the holding company of the two exchanges (ie, Hong Kong Futures Exchange (HKFE) and SEHK) and the three clearing houses (ie, Hong Kong Securities Clearing Company (HKSCC), Stock Exchange of Hong Kong Options Clearing House Company (SEOCH) and Hong Kong Futures Exchange Clearing Corporation (HKCC)). HKEx is itself listed on the Hong Kong stock exchange (SEHK: 0388). The Hong Kong Government is the single largest shareholder in HKEx.

14 Securities and Futures Ordinance, s 19(2).

15 Securities and Futures Ordinance, s 19(6). 'Gazette' is defined under section 3 of the Interpretation and General Clauses Ordinance (Cap1).

16 It was affirmed in *The Stock Exchange of Hong Kong Ltd v New World Development Co. Ltd* [2006] 2 HK LRD 518 that the SEHK operates the exchange pursuant to authority conferred under the Securities and Futures Ordinance, s 19.

17 Securities and Futures Ordinance, s 21(3).

18 Securities and Futures Ordinance, s 21(4).

19 Securities and Futures Ordinance, s 21(5).

- Provide and maintain adequate and properly equipped premises, competent personnel and adequate automated systems.[20]

In performing their duties, the exchange companies are required to act in the interests of the public (having particular regard to the interests of the investing public) and to ensure that, where there is a conflict between the interests of the public and any other interest which it is required to serve under any other law, the interests of the public will prevail.[21]

A recognised exchange company, and any person acting on its behalf, acting in good faith in the discharge of its duties, is immunised from civil liability (whether arising in contract, tort, defamation, equity or otherwise).[22]

Hong Kong Mercantile Exchange Limited (HKMEx) obtained authorisation from the SFC on 26 April 2011 to provide the automatic trading system (ATS) and has commenced trading of gold futures contracts since 18 May 2011. While HKMEx is not the first ATS provider to be authorized by the SFC, nevertheless, its authorization is unique in that it is the first authorized ATS to:

- offer an exchange-like platform for the trading of futures contracts (i.e., a platform that matches buy and sell orders for futures contracts); and
- be solely or primarily regulated by the SFC.

Its position is similar to that of the Hong Kong Futures Exchange Limited (HKFE), which also operates a futures market in Hong Kong, albeit as a recognized exchange company rather than as an authorized ATS provider. The HKMEx provided standardised, cleared and exchange-traded products on a transparent pricing platform to the Asia-Pacific time zone. It was created to eliminate market liquidity risks associated with Asian market participants trading in faraway commodities exchanges such as New York and London.

On 18 May 2013, the HKMEx ceased to trade upon surrendering its authorisation to provide ATS. The Hong Kong Police have made a series of arrests in connection with the exchange, and are investigating its chairman, Mr. Barry Cheung.[23]

Procedures

Only Stock Exchange Participants (SEPs) and Futures Exchange Participants (FEPs) are allowed to deal in securities listed on the SEHK and trade in futures contracts on the HKFE, respectively. The SFO stipulates 10 types of regulated

20 Securities and Futures Ordinance, s 21(6).
21 Securities and Futures Ordinance, s 21(2).
22 Securities and Futures Ordinance, s 22(1). The same immunity is given to a recognised clearing house and exchange controller under Securities and Futures Ordinance, s 39.
23 Bloomberg: http://www.bloomberg.com/news/2013-05-27/hong-kong-police-make-fifth-arrest-in-hkmex-investigation.html.

activities that can be carried on by the SEHK and HKFE participants, corporations or individuals:[24]

- Regulated activity 1: Dealing in securities;
- Regulated activity 2: Dealing in futures contracts;
- Regulated activity 3: Leveraged foreign exchange trading;
- Regulated activity 4: Advising on securities;
- Regulated activity 5: Advising on futures contracts;
- Regulated activity 6: Advising on corporate finance;
- Regulated activity 7: Providing automated trading services;
- Regulated activity 8: Securities margin financing;
- Regulated activity 9: Asset management;[25] and
- Regulated activity 10: Providing credit rating services.[26]

All SEPs and FEPs, corporations or individuals, carrying on any regulated activities have to be licensed by or registered with the SFC. The SFO promulgates a single licensing regime where a person only needs one licence or registration to carry on different types of regulated activities. Each licence holder or regulated institution can hold licences for multiple regulated activities.

For the purpose of obtaining an SFC licence, the corporation will need to appoint at least two responsible officers to supervise each regulated activity it is licensed to

24 On 11 July 2012, the SFC and HKMA published their joint conclusions arising from responses to an earlier consultation paper on the proposed regulatory regime for OTC derivatives in Hong Kong released in October 2011. It was proposed to introduce two new regulated activities: (a) Type 11 regulated activity, which would capture the activities of dealers and advisers in the OTC derivatives market; and (b) Type 12 regulated activity, which will capture the activities of clearing agents including central counterparty (CCP) members and intermediaries between the CCP member and the counterparty. Authorised institutions and authorised money brokers will not have to be licensed (or registered) for the new Type 11 or Type 12 regulated activity; instead, their activities as OTC derivatives dealers, advisers and clearing agents will be overseen by the HKMA. However, they will need to be licensed (or registered) to the extent that their OTC derivatives activities overlap with an existing regulated activity, including the expanded Type 9 regulated activity.

25 The SFC/HKMA conclusion paper of 11 July 2012 (on the proposed regulatory regime for OTC derivatives in Hong Kong) proposed that the existing Type 9 regulated activity will be expanded to cover the management of portfolios of OTC derivatives (and therefore a person holding the expanded Type 9 licence will not be required to have instead a new Type 11 licence).

26 The new Type 10 regulatory regime was introduced in June 2011 to ensure that credit rating agencies are regulated in Hong Kong in a manner that is generally consistent with the enhanced standards that, in recent times, have been adopted in a number of other jurisdictions.

carry on, and at least one of the responsible officers must be a director who actively participates in or is responsible for directly supervising the regulated activity for which the corporation is licensed (known as an Executive Director). Every Executive Director who is an individual must be approved by the SFC as a responsible officer.

The same person may be designated as the responsible officer for different regulated activities, so long as he is found to be fit and proper to be licensed for that regulated activity and has sufficient authority within the corporation to carry out each such activity. In addition, there should not be any conflict of interest or confidentiality issues arising from a responsible officer's multiple functions. At least one of the relevant responsible officers should always be available to supervise each regulated activity, which means that at least one responsible officer must be resident in Hong Kong.

Any individual who carries on a regulated activity on behalf of a corporation will be required to be licensed as a representative accredited to the corporation. The individual will need to satisfy the SFC that he or she is a fit and proper person to be licensed and that grant of the licence will not prejudice the interests of the investing public. A licensed representative may be accredited to more than one licensed corporation. The SFC will refuse to grant a licence to a corporation to carry on a regulated activity unless the applying corporation satisfies the SFC that:

- It is a fit and proper person to be licensed;
- It will be able, if licensed to comply with the financial resources rules; and
- Where required under the SFO and subsidiary legislation, it is insured in accordance with rules made by the SFC.

The insurance requirement is currently only applicable to corporations licensed by the SFC for certain regulated activities. The capital and other financial requirements applicable to corporations licensed under the SFO are set out in the Financial Resources Rules (FRR). All licensed corporations are required to maintain a minimum paid-up share capital (subject to some limited exceptions) and a minimum liquid capital in accordance with the FRR.

The transactions on the SEHK and HKFE are cleared and settled through their three associated clearing houses, namely, the Hong Kong Securities Clearing Company (HKSCC), the Stock Exchange of Hong Kong Options Clearing House Company (SEOCH) and the Hong Kong Futures Exchange Clearing Corporation (HKFCC).[27]

Clearing and settlement in the stock market are carried out by the HKSCC through the Central Clearing and Settlement System (CCASS). For the derivatives market,

27 All three clearing houses are deemed to be 'recognised clearing houses' by virtue of section 6 of Part 1 of Schedule 10 of the Securities and Futures Ordinance.

the HKEx launched the Derivatives Clearing and Settlement System (DCASS) in early 2004. Trading on the SEHK is executed through a customised automated trading system known as the Automatic Order Matching and Execution System AMS/3.

Legal Order and Regulatory Interests

Listing in Hong Kong

Market Participants

Hong Kong Financial Market. Hong Kong ranks among the world's top financial centres, empowered by its favourable geographical location that bridges the time gap between New York and London, its strong links with Mainland China and the economies in Southeast Asia and excellent communication with the rest of the world, the rule of law, a level playing field for conducting business and a sound regulatory regime.

International financial institutions maintain a strong presence in the city. Of the world's top 100 banks, 71 have operations in Hong Kong. The majority of the licensed banks in Hong Kong are foreign-owned. The stock exchange in Hong Kong ranked sixth globally and second in Asia in terms of market capitalisation (approximately HK $22 trillion as of end 2012). Hong Kong remained in the top five worldwide in terms of raising funds through initial public offerings (IPOs) and HK $215 billion in the secondary market in 2012. The financial sector has a 230,400-strong workforce and contributed to 16.1 per cent of Hong Kong's GDP in 2012.[28] The Hong Kong stock market is an important fund-raising platform for Mainland enterprises. At the end of 2012, the 721 Mainland enterprises listed on the SEHK, raising HK$3.2 trillion from the Hong Kong market since 1993.

Foreign intermediaries were increasingly interested in setting up business operations in Hong Kong. The number of Stock Exchange Participants (SEPs) increased from 498 at the end of 2011 to 511 at the end of 2012. The futures market also saw an increase in the number of Futures Exchange Participants (FEPs), from 182 at the end of 2009 to 185 at the end of 2012.

The asset management industry is characterised by its strong international flavour, in terms of the presence of both global fund managers and the different domiciles of authorised funds. As at the end of 2012, 935 companies were licensed or registered to carry out asset management business, representing an increase of nine per cent from a year earlier. In addition to the SFC licensed corporations, banks and insurance companies also participate in asset management business.

Hong Kong also is a platform for offshore RMB settlement and fundraising. At the end of 2012, 204 banks, including 181 overseas banks, had become a Participating Bank of Hong Kong's RMB clearing platform to enable eligible enterprises to

28 *Hong Kong Year Book*, 2012, Ch 4.

settle their merchandise experts in RMB. Hong Kong also is the first place outside Mainland China that has developed an RMB bond market. In 2012 alone, RMB issuance totalled RMB112.2 billion with outstanding RMB bonds amounting to RMB237.2 billion at the end of 2012, up more than 60 per cent from 2011, from a wide range of issuers from Mainland banks to Hong Kong and international corporations.

Relationship with Mainland China. The Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong, which went into force in 2004, gives Hong Kong's financial services suppliers and professionals greater market access and flexibility for their operations in the Mainland. It has also enhanced Hong Kong's attractiveness to market users and strengthened the city's competitiveness as an international financial centre and the premier capital formation centre for Mainland enterprises.

Supplement VI was announced on 9 May 2009 and provides for qualified Mainland securities companies, approved by the China Securities Regulatory Commission (Chinese Securities Regulatory Commission), to set up subsidiaries in Hong Kong in accordance with the relevant requirements. This supplement also allows Hong Kong and Mainland securities companies to set up joint venture securities investment advisory companies (JV firms) in Guangdong. (The JV firm must be a subsidiary of the Mainland securities company, while the Hong Kong company's shareholding in the JV must not exceed one-third of the JV company's total shareholding). Supplement VI also allows both sides to study the introduction of open-ended index tracking ETFs, the portfolios of which are constituted of Hong Kong listed stocks, in the Mainland.

Supplement VII to CEPA was signed on 27 May 2010 and provides for Hong Kong bank's operating institution in the Mainland to apply to conduct RMB business to serve Hong Kong enterprises operating in the Mainland. The Mainland and Hong Kong will deepen cooperation in financial services and product developments, and ETF (open-end index-tracking exchange-traded funds) constituted by Hong Kong listed stocks will be launched in the Mainland.

Supplement VIII to CEPA was signed on 3 December 2011 and allows any Mainland-incorporated banking institution established by a Hong Kong bank to engage in the sale and distribution of mutual funds (and further enhancements in the Renminbi Qualified Foreign Institutional Investor).

Supplement IX to CEPA was signed on 29 June 2012 and allows Hong Kong securities companies, which satisfy the qualification requirements as foreign shareholders of foreign-invested securities companies, and Mainland securities companies, which satisfy the requirements for establishing subsidiaries, to set up equity joint venture securities investment advisory companies in the Mainland. The equity joint venture securities investment advisory company shall be a subsidiary of the Mainland securities company, the scope of business of which shall focus specifically on carrying on securities investment advisory businesses.

The shareholding of the Hong Kong securities company could, at a maximum, reach 49% of the total shareholding of such a joint venture securities investment advisory company.

HKEx also signed a Closer Cooperation Agreement (CCA) with the Shanghai Stock Exchange (SSE) on 21 January 2009 and a CCA with the Shenzhen Stock Exchange (SZSE) on 8 April 2009. The agreements commit HKEx to work more closely with the SSE and SZSE towards the common goals of meeting the domestic and international fund-raising needs of Mainland enterprises, and contributing to the greater development of the Mainland's economy.

Stock Exchange of Hong Kong. The function of prudential regulation of SEPs was transferred to the SFC upon the merger. Prior to SEHK, HKFE and HKSCC becoming subsidiaries of HKEx on 6 March 2000, it was necessary for an SEP or FEP to hold a share in the SEHK or HKFE, respectively, in order to trade on it or through its facilities. Furthermore, shareholders in the SEHK or HKFE had certain rights attached to their shareholdings, including voting rights at the Exchange's general meetings. However, they had no right to participate in the profits of the Exchanges. Following the merger, the shareholders of the Exchanges effectively exchanged their ownership rights in the Exchanges for economic interests in HKEx and the conventional right to receive dividends. Additionally, the previous trading rights of the shareholders remain.

Similarly, primary responsibility for the routine inspection of the businesses of Exchange Participants, monitoring their compliance with conduct rules and liquid capital requirements, and ensuring that they have proper systems of management and control in place, was transferred to the SFC. The HKEx became one of the first stock exchanges in the world to go public. Its shares were listed by way of introduction on the Stock Exchange of Hong Kong on 27 June 2000.

The SEHK operates two markets on which companies may choose to list their shares: the Main Board and the Growth Enterprise Market (GEM Board). The two markets target different types of companies and have different listing requirements. In general, the Main Board is for more established companies and has more stringent financial requirements, such as at least three years of track record and profits of HK $50 million in the past three years. GEM, on the other hand, targets growth companies from all industries and sizes that may not have a track record, but the GEM Listing Rules require companies to have at least 24 months of active business. For the purpose of illustrating key rules in securities regulations in Hong Kong, we will only discuss the application of rules as they relate to the Main Board.

Companies seeking to list securities on the SEHK are required to obtain the approval of and comply with the rules of SEHK. A company may list on the SEHK in various ways, through an initial public offering and/or a private placement of its shares or by way of introduction. Initial Public Offering (IPO) is a commonly used method whereby shares in the company are offered to the public at large. Generally speaking, an IPO can be conducted by way of a public offer of new shares for subscription or a

public offer of issued shares held by existing shareholders for sale or a combination of both. In an IPO, investors can subscribe for the offer shares by using white forms, yellow forms or by EIPO (electronic application). In a private placement, the company will offer its shares to selected investors.

Often, the shares being offered to the public may consist of new shares to be issued by a company (offer for subscription) or a portion of issued shares held by existing shareholders (offer for sale) or a combination of both new and issued shares. Generally, in an offer for sale, the issued shares offered for sale are held by existing major shareholders who intend to cash out part of their shareholdings at the time of the IPO. If a company offers new shares during an IPO, the funds raised from the issue of the new shares will generate proceeds for the company's future use. Funds raised from the sale of issued shares will benefit only those existing shareholders.

Other than by the IPO, a company also may list on the SEHK by way of introduction. In such a case, the company's shares are already widely held by a large number of shareholders prior to listing so that there will be no offer of new or issued shares to the public. Also, a company will not raise funds through this way of listing. The mechanics of these different methods of applying for listing are discussed in the section 'Public Offerings'.

Transborder Electronic Trading Systems. The SEHK has an entirely automated trading mechanism with the development of its new customised automated trading system known as the Automatic Order Matching and Execution System (AMS). This system supports either the manual or the fully automated method of trade execution. Under the AMS, orders entered in respect of auto-match stocks may be matched and executed automatically on the basis of price/time priority. Orders are matched in the order in which they are entered into the AMS based on the best price. The trading of these securities is governed by the SEHK rules 506A (relating to intra-day quotations for bids) and 507A (relating to intra-day quotations for requests) for intra-day quotations.

Short selling (where, for example, a trader can deal in securities that he does not own) is generally prohibited in Hong Kong. However, short selling is permitted on a limited basis (for example, where a viable stock borrowing and lending market was in existence at the time of the sale). All short selling activity is subject to SEHK Rules (in particular, the Short Selling Regulations in the Eleventh Schedule to the Rules). One such rule is that short selling may only be effected through the use of the auto-matching function of the AMS. This is to provide the SEHK with real-time information to assist in monitoring short selling activity.

Settlement of securities trading in Hong Kong was revolutionised by the introduction of the CCASS in June 1992. The CCASS computerises the whole delivery and payment settlement process, and eliminates the need for physical transfer of securities, thereby reducing the level of risks that all interested parties were previously exposed to (credit risk, liquidity risk, replacement risk and

systemic risk). The vast majority of trading on the SEHK now takes place through the CCASS.

Under the CCASS, the HKSCC accepts share certificates from its participants and holds them in the CCASS Depository. Clearing and settlements in the stock market are carried out by the HKSCC through the CCASS. Accordingly, only electronic share credits and values are issued. As the HKSCC is the settlement counterparty to all broker participants, it may be exposed to risk of loss if the other party fails to meet its obligations. Hence, all broker participants of the CCASS are required to, among other things, contribute to a guarantee fund of the HKSCC, have a minimum liquid capital of HK $3,000,000 (as imposed by the Board of HKSCC on 3 October 2005), and, if required by the HKSCC as security, provide a bank guarantee or form of insurance to secure an amount of not less than HK $100 million.

For the derivatives market, the Derivatives Clearing and Settlement System (DCASS) was launched in Hong Kong in April 2004. The DCASS is a fully electronic and automated clearing and settlement system capable of supporting various types of derivatives products. The DCASS comprises the core derivatives clearing and settlement functionality, the margining engine and the Common Collateral Management System (CCMS). The CCMS, which also serves CCASS users, supports the management of collateral for the cash and derivative markets.

Securities Offerings

National Treatment and Reciprocity

The basic conditions which must be met to list securities in Hong Kong are set out in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (Listing Rules)[29] and the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (GEM Listing Rules). These rules are applicable to applicants and issuers on the Main Board and GEM Board, respectively. The SEHK is self-regulatory in nature[30] and has the power to make rules, subject to the supervision of the SFC[31]

29 References to 'Listing Rules' in this chapter refer to the relevant rules and appendices of the Listing Rules, unless otherwise specified.

30 In *Sanyuan Group Ltd v The Stock Exchange of Hong Kong*, FAMV 52/2009, the Court of Appeal confirms the regulator's power to apply a flexible approach to interpret the Listing Rules (Listing Rules 13.24) in a relisting application. The decision is consistent with the function of the Stock Exchange to protect investors and maintain a fair, orderly and efficient market. Applicants seeking to overturn the decision of a regulator should ensure that they have a sound basis for challenge. As Stone J cautioned in the Court of Appeal decision, in the absence of lack of due process or procedural unfairness, 'any court should hesitate long and hard before moving to interfere with the decision of a market regulator'.

31 Section 5(1)(b), Securities and Futures Ordinance. Amendments to the Listing Rules are subject to Securities and Futures Commission's approval under section 24, Securities and Futures Ordinance (Listing Rules 2.05).

and the oversight of the courts. It has absolute discretion to accept or reject an application for listing. Compliance with the conditions set out in the Listing Rules or the GEM Listing Rules does not in itself ensure that an applicant will be accepted as being suitable for listing (or a company could maintain its listed status). The listing of a company on the Exchange is governed in such a way as to ensure that investors have and can maintain confidence in the market.

Prospective applicants are encouraged by the SEHK to approach it for informal and confidential guidance as to the eligibility of a proposed listing at an early stage. The Listing Rules divide securities into two categories, namely, equity securities and debt securities. This chapter presents the key principles and rules governing securities offering with reference to the Main Board Listing Rules only and examines only the rules relating to the listing of equity securities. The key principles of the Main Board Listing Rules and the GEM Listing Rules are set out below:

- Applicants are suitable for listing;
- Issue and marketing of securities are conducted in a fair and orderly manner and potential investors are given sufficient information to enable them to make a properly informed assessment of the issuing company;
- Investors and the public are kept fully informed by the listed companies, and in particular immediate disclosure is made of any information which might reasonably be expected to have a material effect on market activity in, and the prices of, the listed securities;
- All holders of listed securities are treated fairly and equally; and
- Directors of a listed company act in the interests of its shareholders as a whole, particularly where the public represents only a minority of the shareholders.

The conditions set out in the Listing Rules apply to both local and foreign companies, with certain additional requirements, modifications and exceptions which apply in the case of foreign companies. There are also additional rules applicable to investment vehicles,[32] which are beyond the scope of this chapter. Similarly, the Listing Rules apply equally to companies which are new to the capital market and those whose securities are already listed on another exchange. In the case of Mainland incorporated enterprises, certain additional requirements, modifications and exceptions are required to reflect their judicial system and operating environment.[33] The SEHK has also revised rules specific to mineral companies[34] to ensure investors are provided with material, relevant and reliable information relating to mineral and/or petroleum assets.[35]

32 Listing Rules, chs 20 and 21.

33 Listing Rules, ch 19A sets out the additional requirements, modification and exceptions that apply to issuers incorporated in the PRC.

34 'Mineral Company' is defined at Listing Rules 18.01.

35 Listing Rules, ch 18, came into effect 3 June 2010, setting out: (i) additional eligibility and disclosure requirements for new listing of mineral companies; (ii) disclosure

The following sections examine the general requirements of the Listing Rules relating to the company applying for listing, the securities to be listed, and the prospectus to be prepared and distributed in connection with the proposed listing. Rules relating to corporate governance, as well as initiating or registration of public offers, placements and secondary dealings, are also described in the subsequent sections. Any company, local or foreign, seeking to obtain a primary listing on the SEHK must satisfy the conditions set out below.

Issuer Requirements

Due Incorporation. The company applying for listing must be duly incorporated or otherwise established under the laws of the place where it is incorporated or otherwise established and must be in conformity with those laws and its memorandum and articles of association or equivalent documents.[36]

The SEHK reserves the right to refuse to list a foreign company and its securities if it believes that it is either not in the public interest to do so or if it is not satisfied that the foreign company is incorporated or established in a jurisdiction with standards of shareholder protection at least equivalent to those in Hong Kong. Some of these defects may be remedied by amending the foreign company's constitutional documents and/or, in the case of listing of debt securities, the terms of the listing agreement (entered into between the foreign company and SEHK) to provide the requisite standards of shareholder protection.

In general, only companies incorporated in Hong Kong, Bermuda and the Cayman Islands or certain specific types of PRC-incorporated companies are in approved jurisdictions for listing on the SEHK. The SEHK has indicated that a number of other jurisdictions are acceptable for the purpose of a primary listing in Hong Kong.[37]

The SEHK has established a uniform approach for reviewing shareholder protection standards of companies incorporated in other overseas jurisdictions and will view more favourably those jurisdictions whose securities regulators are either full signatories to the International Organization of Securities Commissions Multilateral Memorandum of Understanding concerning Consultation and Co-operation and the Exchange of Information (IOSCO MMoU) or have entered into bi-lateral co-operation agreements with the SFC.

For a Mainland Chinese company, it must be duly incorporated in the PRC as a joint-stock limited company. Its articles of association are required to include all the provisions set out in the set of mandatory provisions for Mainland Chinese enterprises seeking a listing in Hong Kong or elsewhere outside the PRC (ie, *Mandatory Provisions for Companies Listed Overseas*) which are laid down by

requirements for transactions involving mineral and/or petroleum assets; and (iii) continuing obligations to provide update on issuers' mining operations.

36 Listing Rules 8.02.

37 See http://www.hkex.com.hk/eng/rulesreg/listrules/listsptop/listoc/list_of_aoj.htm (as updated from time to time).

the People's Republic of China State Council Securities Policy Committee and the State Commission for Restructuring the Economy System.[38] In addition to these provisions, a Mainland Chinese company is required to include in its articles of association provisions relating to, *inter alia*, the protection of class rights and the change, removal and resignation of auditors.

Accounts and Financial Periods. The prospectus must contain an accountants' report (including balance sheets, income statements and cash flow statements) on the last three audited financial year results.[39] To ensure that investors are able to rely on information which is as up to date as can reasonably be expected, the most recent financial period reported in the prospectus must not have ended more than six months before the date of the prospectus, otherwise, an interim (or stub) set of accounts is required for part of the current financial year.[40]

The SEHK will not normally consider an application for listing from any company which has changed the dates of its financial year during the 12 months immediately preceding the proposed date of issue of the prospectus; or which intends to change its financial year-end during the period of its profit forecast as set out in the prospectus or during its current financial year. However, where there are genuine and valid reasons for change in a company's financial year-end, the SEHK may be prepared to waive this requirement, subject to a strict scrutiny process.

All accountants' reports must be prepared in conformity with Hong Kong Financial Reporting Standards or International Financial Reporting Standards (or China Accounting Standards for Business Enterprises in the case of a PRC-incorporated company that has adopted such standards for the preparation of its annual financial results).[41]

Adequate Track Record under Same Management. The company must demonstrate management continuity for at least the last three preceding financial years and ownership continuity and control for at least the most recent audited financial year. The company also must satisfy either the profit test, the market capitalisation/revenue/cash flow test, or the market capitalisation/revenue test set out below:

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38 Set forth in *Zheng Wei Fa* (1994), Number 21, issued on 27 August 1994 (Listing Rules Appendix 13, Part D).

39 Listing Rules 4.04 and 4.05, and paras 27 and 32 of the Third Schedule to the Companies Ordinance.

40 Listing Rules 8.06.

41 Listing Rules 4.11. Hong Kong listed entities that are domiciled in Mainland China may submit financial information to Hong Kong securities regulators using China Accounting Standards for Business Enterprises. These companies also can appoint PRC audit firms vetted by China's Ministry of Finance to act as their auditors and reporting accountants.

	Track Record	Requirements
Profit test[42]	A trading record of not less than three financial years during which profit attributable to shareholders in the most recent year must not be less than HK $20 million, and in respect of the two preceding years be in aggregate not less than HK $30 million, in the ordinary course of business	
Market capitalisation/ revenue/cash flow test[43]	Trading record of at least three financial years	Market capitalisation of at least HK $2 billion; at the time of listing; revenue of at least HK $500 million for the most-recent audited financial year; and positive cash flow of at least HK $100 million in total for three preceding financial years
Market capitalisation/ revenue test[44]	Trading record of at least three financial years	Market capitalisation of at least HK $4 billion; revenue of at least HK $500 million for the most recent audited financial year

Many potential applicants query whether the company's acquisitions prior to listing can be grouped together to meet the track record criteria. While a company is free to acquire and dispose of assets at any time, it may be difficult to satisfy the SEHK that the company meets the management and ownership continuity requirements where it has acquired new businesses during the track record period or where the companies comprising the group to be listed have been recently organised into a group. The following factors will be taken into account where the company has acquired new businesses during the track record period:[45]

- Whether the new business forms a material part of the company's business at the time of listing;
- Whether the new business is forecast to make a material contribution to the company's profit forecast;

42 Listing Rules 8.05(1).
43 Listing Rules 8.05(2).
44 Listing Rules 8.05(3).
45 Listing Rules, para 4 of PN3.

- Whether the new business is in a similar line to that of the company's previous business activities and is part of the logical growth trend of the business;
- Whether the company has retained the management of the new business and whether it can be demonstrated to the SEHK that necessary continuity and synergy of the management is provided;
- The period of time which has elapsed since completion of the acquisition; and
- Whether the new group has been formed solely for the purpose of satisfying the listing requirements or to enhance the apparent attractiveness of the group as a new applicant for listing.

Generally, the issue of materiality and compliance with the requirements set out above will be determined by the SEHK, in its sole discretion. There are a number of specific rulings on management and ownership continuity which are beyond the scope of this chapter, details of which are available on the HKEx website.

The SEHK encourages potential listing companies which have made acquisitions during the track record period, which intend to make an acquisition prior to listing or where there has been a material change in management or ownership of the company during the track record period to contact the SEHK for confidential advice before submitting a listing application.[46]

Where a new applicant acquires any material subsidiary or business during the trading record period and such an acquisition if made by a listed company would have been classified as a major transaction or a very substantial acquisition,[47] it must disclose pre-acquisition financial information on that material subsidiary or business from the commencement of the trading record period (or, if the material subsidiary or business commenced its business after the commencement of the trading record period, then from the date of the commencing of its business) to the date of acquisition. Pre-acquisition financial information on the material subsidiary or business must normally be drawn up in conformity with accounting policies adopted by the new applicant and be disclosed in the form of a note to the accountants' report or in a separate accountants' report.[48]

Working Capital Requirements. The company applying for listing on the SEHK must include a working capital statement in the prospectus, stating that it and its subsidiaries, if any, have available sufficient working capital for the group's requirements for at least the next 12 months from the date of publication of the prospectus. The sponsor of the new applicant also must confirm to the SEHK that:[49]

- It has obtained written confirmation from the company that the working capital is sufficient; and

46 Listing Rules 2.06.

47 The classification of major transactions and very substantial acquisitions is discussed in the section headed 'Regulated Market and Compliance with Listing Rules', below.

48 Listing Rules 4.05A

49 Listing Rules 8.21A.

- It is satisfied that this confirmation has been given after due and careful enquiry and that the persons/institutions providing finance have stated in writing that the relevant financing facilities exist.

The SEHK makes an exception for a new applicant whose business is entirely or substantially that of the provision of financial services, provided the inclusion of such a statement would not provide significant information for investors; and the new applicant's solvency and capital adequacy are subject to stringent supervision by another regulatory body. In the case of a mineral company, it must have available working capital to meet 125 per cent of the group's working capital needs for the next 12 months.[50]

Suitability for Listing. The company and its business must, in the opinion of the SEHK, be suitable for listing.[51] A company (other than an investment company) whose assets comprise wholly or substantially of cash or short-dated securities will not normally be regarded as suitable for listing. The SEHK retains the discretion to decide on whether an applicant is suitable for listing.

A company that satisfies all the technical requirements, but is rejected for listing on policy grounds (ie, suitability for listing), may appeal such decision to the Listing (Review) Committee[52] (and, if unsuccessful, to the Listing Appeals Committee).[53]

Protection for Minority Shareholders. The Listing Rules provide that, in case of both primary and secondary listing on the SEHK, the foreign company must show that the jurisdiction in which it is incorporated or established provides the same standards of shareholder protection as those provided in Hong Kong.[54]

In respect of companies incorporated in Bermuda, the Cayman Islands and the PRC, additional requirements are set out in Appendix 13 and Chapter 19A of the Listing Rules.

Local Management Presence. The company must have sufficient management presence in Hong Kong.[55] This will usually require at least two of the executive directors to be ordinarily resident in Hong Kong.

In SEHK's guidance letter (GL9-09), the SEHK sets out the conditions it would normally expect to see in any application for a waiver of strict compliance with this requirement, which focus on the communication arrangement with the SEHK.

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50 Listing Rules 18.03(4) and 18.03(5).
51 Listing Rules 8.04.
52 Listing Rules 2B.05.
53 Listing Rules 2B.07.
54 Listing Rules 19.05(1)(b).
55 Listing Rules 8.12.

Securities Requirements

In General. The shares must be admitted to trading on the Main Board[56] or the GEM Board. The securities for which listing is sought must be freely transferable. Partly-paid securities will normally be regarded as fulfilling this condition provided that in the view of the SEHK their transferability is not unreasonably restricted and dealings in them can take place on an open and proper basis.[57]

Existing issued securities which are offered for sale on an instalment payment basis, approved by the Exchange, will normally be regarded as fulfilling this condition.[58]

Sufficient Public Interest and Public Float. There must be an open market in the securities for which listing is sought. This will normally mean that at least 25 per cent of the company's total share capital must at all times be held by the public, subject to exemptions and the discretion of the SEHK in accepting a lower percentage.[59] The definition of 'the public' expressly states the SEHK will not regard any connected person,[60] any person financed by a connected person, or any person who is a customer to take instructions from a connected person in relation to the acquisition, disposal, voting or other disposition of securities, as members of the public.[61] Hong Kong market practice is for there to be a retail part of the Hong Kong offering.

Where a new applicant has a controlling shareholder (holding 30 per cent or more voting rights with specific rules for PRC-incorporated companies) with an interest in a business apart from the applicant's business which competes or is likely to compete, either directly or indirectly, with the applicant's business, the applicant must make certain disclosures and comply with certain requirements to the satisfaction of the SEHK.[62]

Market Capitalisation. At the time of listing, the market capitalisation, including the newly listed shares, must be at least HK $200 million.[63]

Fair Voting Rights. The share capital of the company applying for listing must not include any shares with a voting power which does not bear a reasonable relationship to the equity interest of such shares.[64]

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56 Listing Rules 2A.05.
57 Listing Rules 8.13.
58 Listing Rules 8.13.
59 Listing Rules 8.08.
60 The term 'connected person' is very widely defined in the Listing Rules. This generally includes directors (including persons who were directors in the last 12 months), chief executive, substantial shareholders (defined as holders of 10 per cent or more of the listed company's shares) of the listed company or any of its subsidiaries or an associate of any of them.
61 Listing Rules 8.24 (also see discussion under section headed 'Securities Offering - Public').
62 Listing Rules 8.10.
63 Listing Rules 8.08 and 8.09(2).

Transferability. The shares for which listing is sought must be freely transferable.[65]

Eligible Securities. The securities must be accepted as being eligible by the HKSCC for deposit, clearance and settlement in the CCASS in accordance with the General Rules of CCASS from the date on which dealings in the securities are to commence.

The company also must make all the necessary arrangements to ensure that the securities for which listing is sought comply with this requirement and will continue to comply after dealings in them commence. The SEHK has absolute discretion to waive compliance with the above requirement, but will only do so in exceptional circumstances.

Validly Issued Securities. The securities for which listing is sought must conform to the laws of the place where the foreign company is incorporated (or otherwise established), as well as the company's constitutional documents.

All authorisations required for the creation and issue of the securities under such law or constitutional documents of the company must have been duly given.

Listed Securities. Where an application for listing is made in respect of any class of securities, if none of the securities of that class are listed, the application must relate to all the securities of that class issued or proposed to be issued; or if some of the securities of that class are already listed, the application must relate to all further securities of that class issued or proposed to be issued.[66]

Hong Kong Registrar and Register. Every local company must employ an approved share registrar to maintain its register of shareholders in Hong Kong. A foreign company must arrange for a register of Hong Kong shareholders to be maintained and for transfers to be registered in Hong Kong.

Only in exceptional circumstances may the SEHK consider an alternative arrangement for registration of transfers for Hong Kong shareholders, in which case a share transfer agent will have to be appointed in Hong Kong.[67] Usually, only securities registered on the Hong Kong Register may be traded on the SEHK.[68] Where the foreign company has two or more share registers (one of which is maintained in Hong Kong), the Hong Kong register need only contain particulars of the shares registered in Hong Kong.[69]

A scriptless securities regime also will be implemented to provide investors with flexibility of holding securities in physical certificates or in paperless form. The

64 Listing Rules 8.11.
65 Listing Rules 8.13.
66 Listing Rules 8.19.
67 Listing Rules 19.30(4).
68 Listing Rules 19.30(5).
69 Listing Rules 19.30(6).

paperless option will enable investors to hold securities in their own names as registered holders. The Companies (Amendment) Ordinance 2010 removes existing limitation in the Companies Ordinance that compels the issue or use of paper documents of title and transfer.

Service of Process. A foreign company is normally required to appoint, and maintain the appointment of, an agent authorised to accept service of process and notices on its behalf in Hong Kong. The SEHK will require certain prescribed information relating to the process agent.

Notice must be given to the SEHK of the appointment of any such process agent,[70] and any termination of appointment. There is an equivalent obligation imposed on the foreign company by Part XI of the Companies Ordinance.[71]

Accountant and Property Valuation Reports. The reporting accountants and property valuers acting for any company must be shown to have the requisite level of skills and experience required by the SEHK.

Debt Securities. The types of debt securities which can be listed on the Exchange are:

- Debt securities listed under Chapter 22 to Chapter 36 of the Listing Rules — this kind of debt securities can be invested by public investors.
- Debt securities listed under Chapter 37 of the Listing Rules — this kind of debt securities are offered to professional investors only and not offered to public investors in Hong Kong.[72]

Debt securities listed on the HKEx can also be categorised into various categories, including Corporate Bonds, Convertible Bonds, Exchange Fund Notes (EFN), and Government/Supranational bonds (GSB) Prospectus Requirements.

In General. 'Prospectus' is defined in section 2 of the Companies Ordinance as follows:

> '(a) subject to paragraph (b), means any prospectus, notice, circular, brochure, advertisement, or other document –
>
> > '(i) offering any shares in or debentures of a company (including a company incorporated outside Hong Kong, and whether or not it has established a place of business in Hong Kong) to the public for subscription or purchase for cash or other consideration; or

70 Listing Rules 19.30(2).

71 Companies Ordinance, s 333.

72 Listing documents for debt issues to professional investors only are not distributed beyond the initial investors. However, these issuers have a continuing obligation to disclose any price sensitive information by way of announcements on the HKEx news website.

> ‘(ii) calculated to invite offers by the public to subscribe for or purchase for cash or other consideration any shares in or debentures of a company (including a company incorporated outside Hong Kong, and whether or not it has established a place of business in Hong Kong);
>
> ‘(b) does not include any prospectus, notice, circular, brochure, advertisement, or other document –
>
> ‘(i) to the extent that it is a publication falling within section 38B(2); or
>
> ‘(ii) to the extent that it contains or relates to an offer specified in Part 1 of the Seventeenth Schedule as read with the other Parts of that Schedule.’

Any listing document that is within the definition of ‘prospectus’ must comply with the requirements of the Listing Rules and the Companies Ordinance (in particular, the Third Schedule to the Companies Ordinance). This is irrespective of whether the company is incorporated within or outside Hong Kong.

Every prospectus is required to be registered with the Registrar of Companies. The Registrar of Companies will only register a prospectus if it is authorised to do so by the SEHK. The SEHK will review a prospectus for compliance with both the Listing Rules and the Companies Ordinance.

It will not authorise a prospectus for registration by the Registrar of Companies until it is satisfied that it has no further comments on such prospectus in respect of both the Listing Rules and the Companies Ordinance requirements, and is prepared to grant a listing of the securities to which such prospectus relates. In very limited circumstances, exemptions from compliance with the technical requirements of the Companies Ordinance may be obtained from the SFC.[73]

Companies Ordinance Requirements. A company offering securities (both equity and debt securities) to the public is required to register a prospectus in compliance with the provisions of the Companies Ordinance.[74] A company is exempted from the requirements of the Companies Ordinance where:

- The offer is a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the securities;[75]
- The securities (or debentures) in question are not offered to the public;[76]

73 Companies Ordinance, ss 38A and 342A.
74 Companies Ordinance, ss 38(3) and 342(3).
75 Companies Ordinance, s 38(3)(a).
76 Companies Ordinance, s 38(3)(a).

- The offer is to existing holders and relates to shares in (or debentures of) the company, whether or not there is a right to renounce in favour of other persons;[77] or
- The offer relates to shares (or debentures) of a type which is in all respects uniform with the shares (or debentures) previously issued and for the time being listed on the Stock Exchange of Hong Kong.[78]

Prospectus Requirements. A prospectus must be dated. Unless the contrary is proved, that date shall be taken as the date of publication of the prospectus.[79]

The prospectus must either be in English and contain a Chinese translation, or in Chinese and contain an English translation.[80] The SFC exercised its powers under section 38A to enable the issue of separate English and Chinese versions of a prospectus, so long as both versions are available to the public at each place where, and for so long as, the distribution of the prospectus continues. The prospectus[81] must contain the following statement in a prominent position:[82]

'Important - If you are in any doubt about any of the contents of this prospectus, you should obtain independent professional advice.'

Under section 38(1) of the Companies Ordinance, a prospectus must contain the information specified in Part I of the Third Schedule, which includes:

- The general nature of the business of the company;
- The authorised and issued share capital;
- The financial condition and profitability of the company;
- The details relating to the directors, including their names, descriptions, addresses and the provisions in the articles of association relating to their remuneration and share qualification;
- The particulars relating to the shares offered to the public for subscription or sale;
- The details of any property to be acquired with the proceeds of the share issue;
- The expenses of the share issue;
- The interests of the directors and the promoters of the company in any property to be acquired by the company;
- The contents of the articles of association of the company with regard to any borrowing powers;

77 Companies Ordinance, s 38(5)(a).
78 Companies Ordinance, s 38(5)(b).
79 Companies Ordinance, s 37.
80 Companies Ordinance, s 38(1).
81 If there is any doubt about any of the contents of this prospectus, one should obtain independent professional advice.
82 Companies Ordinance, s 38(1A). The statement is specified in Part 1 of Schedule 18 to the Companies Ordinance. The Chinese version of the statement also is prescribed.

- The particulars of any bank overdrafts or other similar indebtedness of the company;
- The particulars of any hire purchase commitments, guarantees, or other material contingent liabilities of the company and its subsidiaries;
- The particulars of the issued debentures of the company and its subsidiaries;
- The particulars of the auditors of the company;
- The particulars of the company's material contracts;[83] and
- The gross trading income or sales turnover of the company during the three preceding years.

In addition, Part II of the Third Schedule requires a number of reports to be set out in the prospectus, namely:

- A report by the auditors of the company on the profits and losses, assets and liabilities, and the rates of dividends paid by the company in the three preceding years;
- A report by the accountants of the company on the profits and losses and the assets and liabilities of any business to be acquired with the proceeds of the share issue; and
- A valuation report with respect to all of the company's interests in land or buildings which exceed 10 per cent of the value of the assets of the company, or which have a value which is equal to or more than HK $3 million.

A breach of section 38(1) and (1A) of the Companies Ordinance will render the company and any knowing party liable to a fine.[84] Any contract purporting to exclude the requirements of section 38 of the Companies Ordinance is void.[85] Compliance with section 38 does not limit or diminish any liability under general law or the Companies Ordinance.[86]

Listing Rules. The SEHK's contents requirements set out in Appendix 1 of the Listing Rules apply to all listing documents, whether or not the listing document in question constitutes a prospectus as defined in the Companies Ordinance. Parts A and B of Appendix 1 set out the contents requirements which apply to listing of equity securities. Part C of Appendix 1 deals with listing of debt securities, and

83 The general view is that a contract is material if knowledge of its existence can reasonably be expected to affect the share price of the company (regardless of whether the affect on price is great or small). The dates, parties and general nature of every material contract must be disclosed. Contracts that are entered into in the ordinary course of business of the company, or more than two years before the date of issue of the prospectus, are generally not considered material.

84 Companies Ordinance, s 38(1B).

85 Companies Ordinance, s 38(2).

86 Companies Ordinance, s 38(6).

Part D of Appendix 1 deals with structured products. Parts E and F of Appendix 1 deal with listing of depositary receipts.

Apart from the requirements of Appendix 1, a company applying for listing also is required to consider the modifications set out in the relevant sections of the Listing Rules (eg, the detailed requirements for accountants' and property valuers' reports in chapters 4 and 5 of the Listing Rules). In the case of equity securities, chapter 19 (Foreign issuers) and chapter 19A (Issuers incorporated in the PRC) of the Listing Rules may be relevant.

A listing document is defined[87] as a prospectus, a circular and any equivalent document (including a scheme of arrangement and introduction document) issued or proposed to be issued in connection with an application for listing.[88] The listing document must be in English accompanied by a Chinese translation.[89]

A listing document which is a prospectus within the meaning of the Companies Ordinance[90] also must comply with and be registered with the Registrar of Companies in accordance with the Companies Ordinance.[91] The latest financial period reported on by the reporting accountants in a listing document must not have ended more than six months before the date of the listing document.[92]

The final proof of the listing document must be lodged with the SEHK.[93] A pilot scheme requiring new listing applicants to post a web-proof information pack (WPIP) on the HKEx news or the Growth Enterprise Market website, as applicable, prior to the issue of an IPO prospectus was commenced on 1 January 2008. The pilot scheme is intended to help level the playing field for institutional and retail investors in the receipt of information about a listing applicant prior to the commencement of the public offering.

Corporate Governance

In General

'Corporate governance' refers to the system by which companies are directed and controlled (as opposed to 'management', which refers to the way in which companies are operated). The SFC, the SEHK and the Registrar of Companies take an active interest in promoting corporate governance in Hong Kong.

The SFC acts as an independent statutory body with licensing and supervisory powers over the securities, futures and financial investment industries, to ensure the integrity of the securities market and promote Hong Kong as an international financial centre. Where listed companies are concerned, the HKEx performs a

87 Listing Rules 1.01.
88 Listing Rules 11.03.
89 Listing Rules 11.14.
90 Listing Rules 11.01.
91 Listing Rules 11.01.
92 Listing Rules 8.06.
93 Listing Rules 11.02.

self-regulatory function by regulating listed companies, with all its rules being subject to SFC approval. The Registrar of Companies also has an active and increasing (through the Companies Ordinance rewrite) role in the development of corporate governance practices in Hong Kong. The common regulatory objective is to ensure that directors conduct the company's business fairly, with due regard for the interests of public shareholders and other stakeholders.

However, 'fairness' is judgemental and difficult to regulate directly. Hence, in reality, regulators tend to focus on the processes of corporate governance by setting rules, such as board composition, voting procedures and adequacy of disclosures to monitor compliance with these processes, and try to reinforce them with education about ethical standards. This section will provide an overview of the rules in Hong Kong relating to corporate governance.

Code on Corporate Governance Practice

In General. The HKEx enacted the Corporate Governance Code (the Code) in 2012 (previously the Code on Corporate Governance Practices in 2005, which replaced the 1993 Code of Best Practice).[94] The regulatory framework is designed to give issuers flexibility in implementing its corporate governance systems whilst protecting investors and the market. The Code sets out the principles of good corporate governance and contains two levels of recommendations: (a) code provisions, which are rules that listed companies are expected to comply with but may choose to deviate from; and (b) recommended best practices, which are for guidance only. Companies also may devise their own corporate governance policy on such terms as they may consider appropriate. Listed companies must state whether they have complied with the code provisions as set out in the Code for the relevant accounting period in their interim reports (and summary interim reports, if any) and annual reports (and summary annual reports, if any).[95] Where a listed company deviates from the code provisions as set out in the Code, it must give considered reasons.[96] In the case of the recommended best practices, listed companies are encouraged, but are not required, to state whether they have complied with them or give considered reasons for any deviation.[97] The following summarises briefly the essential core provisions and recommended best practices under the Code:

	Code Provisions	**Recommended Best Practices**
Board Meetings	• The board should meet at least four times a year at approximately quarterly intervals	• Insurance coverage is required for directors and officers (section 165 of the Companies

94 This section provides a non-exhaustive outline on the Corporate Governance Code. Particular attention should be drawn to the amendments to the Listing Rules and the Code, which will take effect on 1 January 2012, 1 April 2012 and 31 December 2012.

95 Listing Rules 3.25(2).

96 Listing Rules 3.25(3).

97 Listing Rules 3.25(4).

	• 14 days' notice must be given of regular board meeting~~s~~ • Directors should have access to the advice and services of the company secretary who should also record and circulate detailed board minutes • Directors are to have access to independent professional advice at the company's expense • If a substantial shareholder (10 per cent or more) or a director has a conflict of interest in a matter to be considered by the board which the board has determined to be material, the matter should not be dealt with by way of a written resolution or by a committee – a full board meeting should be held and all independent non-executive directors who, and whose associates, have no material interest in the matter should attend	• Ordinance also contains restrictions on the types of insurance that the issuer can arrange) • Board committees should adopt, as far as practicable, the principles, procedures and arrangements in the Code
Chairman and CEO	• There must be separate chairman and CEO roles with division of responsibilities • The chairman should ensure that all directors are properly briefed and provided with complete and reliable information on issues arising at board meetings	• The chairman should provide leadership to the board, ensure that the board discharges its responsibilities and that all key issues are discussed in a timely manner • The Chairman should encourage directors' contribution, meet with non-executive directors, ensure effective

		communication with shareholders, facilitate effective contribution of non-executive directors and ensure constructive relations between executive and non-executive directors
Board Composition, Appointments, Re-election, Removal	• Independent non-executive directors must be identified in communications • One-third of board must consist of INEDs[98] • Directors must be named on the website • There must be formal induction for new directors • Compliance with the Model Code for Securities Transactions is required • Non-executive directors must be appointed for a specific term and should retire by rotation every three years	• An INED serving more than nine years should be subject to separate shareholders' approval • Nomination committee must be established with majority of members being INED, with published terms of reference established and being provided with sufficient resources • Circular to shareholders must set out credentials of INEDs before election
Directors' Responsibilities	• Training to be provided and compliance disclosed in the Corporate Governance Report • Formal induction is required for new directors • Non-executive directors must contribute with independent viewpoint • Directors should ensure they can give sufficient time to the affairs of the issuer	• Disclosure of all other offices held by all directors is required • Non-executive directors must give the board benefit of their skills through active participation

98 This will become mandatory as of 31 December 2012. Listing Rules 3.10A.

	• Compliance with Model Code for Securities Transactions is required	
Access to Information	• Board meetings agenda must be provided at least three days before meeting • Management must supply the board and its committee adequate, complete and reliable information • Directors must have access to properly prepared board papers and related materials	
Remuneration of Directors and Senior management	• Remuneration committee, made up by a majority of independent non-executive directors with specific written terms of reference (and providing for various duties) and provided with sufficient resources must be established[99] • Professional advice must be sought when necessary	• Significant proportion of executive directors' remuneration should be structured as to link rewards to corporate and individual performance • Appropriate disclosures must be made on annual report of senior management remuneration • There must be disclosure of remuneration not approved by committee
Accountability and Audit	• Management must provide the board financial reports to make informed decisions for approval • Board must present a balanced, clear and understandable assessment and disclosure in the annual and interim reports	• Publication of quarterly financial results within 45 days of quarter end is required • Ongoing monitoring of risks and internal control must be considered

99 The Listing Rules was amended (effective 1 April 2012) to require issuers to set up a remuneration committee with specific terms of reference and the committee's chairman and a majority of the members to be independent non-executive directors. Listing Rules 3.25-27

	• There must be annual review of internal control	
Delegation by the Board	• Proper delegation to management and proper communication with and approval from the board before decision making must be provided • Sufficiently clear terms of reference for committees and feedback to the board must be prescribed	• Division of responsibility between board and management must be disclosed
Communication with Shareholders	• A 20-day notice for AGM is required • Proper resolutions at each general meeting must be prepared • Procedures for voting by poll in place must be provided[100]	

Directors' Qualifications. Each director must satisfy the requirements of Chapter 3 of the Listing Rules, including satisfying the SEHK that he has the necessary character, experience and integrity to act as director of a listed company.

The board must include at least three independent non-executive directors and at least one of the independent non-executive directors must have appropriate professional qualifications or accounting or related financial management expertise.[101]

Competing Business of Controlling Shareholder. If the controlling shareholder (being a person, or group of persons, who exercise or control the exercise of control of 30 per cent or more of the company or who is in a position to control the composition of a majority of the board) or any director of the company has an interest in a business which competes or is likely to compete, either directly or indirectly, with the company's business, various disclosures must be made in the listing document.

Statutory Protection for Auditors. Auditors of all listed companies are accorded statutory protection which enables them to report any reasonable suspicion of

100 The Listing Rules require voting by poll on all resolutions at general meetings.
101 Listing Rules 8.15.

fraud to the SFC or other appropriate authorities without having to risk an action being brought against them for any civil liability (including breach of confidentiality and for defamation).[102]

The New CO also provides for qualified privilege for any oral and written statements an auditor may make during the course of an audit and in respect of their resignation.[103]

Financial Reporting Council. The Financial Reporting Council is an independent statutory body set up under the Financial Reporting Council Ordinance. The Financial Reporting Council was established on 1 December 2006 and became fully operational on 16 July 2007. The Financial Reporting Council is responsible for:

- Conducting independent investigations into possible auditing and reporting irregularities in relation to listed companies;
- Enquiring into possible non-compliances with financial reporting requirements on the part of listed companies; and
- Requiring listed companies to remove any non-compliance identified.

The Financial Reporting Council may initiate investigations or enquiries upon receipt of complaints or on its own initiative. Any person who possesses information and/or evidence which suggest that there are or may be auditing and reporting irregularities or non-compliances with financial reporting requirements may lodge a complaint with the Financial Reporting Council.

Any auditing or reporting irregularities identified by the Financial Reporting Council will be referred to the Hong Kong Institute of Certified Public Accountants for follow-up action. Any non-compliance relevant to the Listing Rules will be referred to the SFC or the SEHK for follow-up action. The Financial Reporting Council is not empowered to discipline or prosecute. Since its establishment, over 50 complaints have been reviewed, of which seven have been investigated with three enquires made.

The Financial Reporting Council has established co-operation arrangements with Mainland regulators on investigations and enquiries. Enquiries into the conduct of PRC audit firms are also subject to PRC law. In practice, formal investigations of PRC audit firms will be carried out by the PRC Ministry of Finance and the Chinese Securities Regulatory Commission, either as agents on behalf of the Financial Reporting Council (to the extent permitted by PRC laws) or on a direct complaint. These regulators are responsible for taking appropriate disciplinary actions and sanctions against PRC audit firms.

New Companies Ordinance ("New CO"). In mid-2006, the Hong Kong Government launched a major and comprehensive exercise to rewrite the

102 Securities and Futures Ordinance, ss 380 and 381.
103 Company Bill, s 401.

Companies Ordinance. It has been proposed that the New CO will come into effect from March 2014. The New CO seeks to enhance corporate governance, improve company regulations and business facilitation and modernise Hong Kong's corporate law. Some of the notable measures in the New CO include:

- Removing the requirement for memorandum of association and the concept of authorised capital;
- Restricting the appointment of corporate directors by requiring at least one individual director;
- Reducing the threshold for shareholders to demand a poll from 10 per cent to five per cent of the total voting rights;
- Requiring public and large private companies and guarantee companies to prepare a more comprehensive directors' report which includes an analytical and forward looking 'business review' while allowing private companies to opt out by special resolution;
- Granting power to require a wider range of persons to provide information and explanation reasonably required for auditors' performance of duties; and
- Enabling the Registrar of Companies to obtain documents or information for ascertaining whether any conduct, that could constitute certain offences relating to giving false or misleading statement, has taken place.

Public Offerings

In General. A company seeking listing on the SEHK can offer its shares to the public by way of an offer for subscription or an offer for sale, or a combination of both.

Offer for Subscription. An offer for subscription also is referred to as a primary offering. The issuing company, or an intermediary on its behalf, offers new shares to the public, and the members of the public accepting the offer subscribe to the shares.[104] Offers for subscription can be made at a fixed price or by tender. In the latter case, the minimum price of the shares is fixed and offers are invited at a higher price, with the shares generally being issued to the highest bidder.

In the case of an offer for subscription by tender, the SEHK must be satisfied as to the fairness of the basis of the allotment so that investors who tender at the same price for the same number of shares receive equal treatment.[105] In any case, the issuing company and its underwriters must adopt a fair basis of allocating the shares on offer to the public (whether the offer is made at a fixed price or by tender).[106] Offers for subscription of new shares must be fully underwritten, and an offer for subscription must be supported by a listing document which complies with the requirements of chapter 11 of the Listing Rules.[107]

104 Listing Rules 7.02.
105 Listing Rules 7.04.
106 Listing Rules 8.23.
107 Listing Rules 7.05.

Offer for Sale. An offer for sale is a secondary offering, where the shares offered for sale had already been issued by the listing company. The existing shareholders, or an intermediary on their behalf, offer their shares to the public for sale and the members of the public accepting the offer purchase the shares from the existing shareholders.[108]

Similar to offers for subscription, offers for sale can be made at a fixed price or by tender. Again, the SEHK must be satisfied as to the fairness of the basis of allotment so that investors who apply at the same price for the same number of securities receive equal treatment. There is, however, no specific requirement for an offer for sale to be underwritten but, in practice, underwriting arrangements are often made to ensure that the requirement for the public float requirement is met.[109] In the case of an offer for sale, a listing document which complies with Chapter 11 of the Listing Rules also is required.[110]

Placements

A private placement involves an issuing company either directly or through an intermediary obtaining subscriptions for shares primarily from persons selected or approved by the issuing company or its intermediary.[111] The shares are taken up by a restricted number of investors (usually in very substantial blocks) pursuant to arrangements generally made on behalf of the issuing company by a placement agent or a firm of stockbrokers. The shares are not offered to the general public. A private placement often involves the shares in question being offered selectively by the issuing company's sponsor or the intermediary appointed to manage the placement.

Where a placement of securities of a class new to listing is proposed by or on behalf of a new applicant or a listed company, a listing document which complies with Chapter 11 of the Listing Rules is required. A placement of securities of a class already listed by or on behalf of a listed company does not need to be supported by a listing document. However, if a prospectus or other listing document is required (for other reasons) or is proposed to be issued, it must comply with Chapter 11 of the Listing Rules.[112]

The SEHK will not usually allow a new applicant to be listed by way of a private placement if there is likely to be significant public demand for the shares.[113] In the case of applicants with a very large market capitalisation, a combination of a public offer and private placement is often adopted. The SEHK may be prepared to allow preliminary arrangements and private placements to be made to distribute shares before the start of dealings when necessary to comply with the minimum

108 Listing Rules 7.06.
109 Listing Rules 8.08(a). See also section headed 'Securities Requirements', above.
110 Listing Rules 7.08.
111 Listing Rules 7.09.
112 Listing Rules 7.12.
113 Listing Rules 6.11.

public float requirement.[114] If a private placement is to be made, then further separate guidelines contained in Appendix 6 of the Listing Rules will apply. In the case of new applicants, the main guidelines include:

- The expected initial market capitalisation of the shares to be placed must not be less than HK $25 million (or such other amount as may be fixed from time to time by the SEHK);[115]
- Up to, but not more than, 75 per cent of the shares to be placed may be placed directly by a member of the SEHK (the lead broker) or through a syndicate of other members of the SEHK (distributors);[116]
- The shares to be placed must have an adequate spread of holders. The number of shareholders considered adequate depends on the size of the placement but, as a general guideline, there should not be fewer than three shareholders for each HK $1 million of the placement with a minimum of 100 shareholders;
- Without the prior consent of the SEHK, no allocations may be made to (a) 'connected clients'[117] of the lead broker or of any distributor; (b) directors or existing shareholders of the company or their associates, unless certain conditions[118] are fulfilled; or (c) nominee companies, unless the name of the ultimate beneficiary is disclosed;
- Not more than 25 per cent of the total placement may be allocated to 'discretionary managed portfolio';[119]
- Not more than 10 per cent of the total placement may be offered to employees or past employees of the company applying for listing;[120]
- Neither the lead broker nor the distributor, under normal circumstances, may retain for their own account any significant amount of the shares being placed;
- Dealing in the shares cannot commence until the SEHK has been supplied with, and has approved a list setting out, the required details of all the placees and the amount taken up by each placee (with the possibility that the SEHK may request

114 Listing Rules 7.11 and Listing Rules 8.08(a).

115 This will normally not apply to placements by foreign issuers having their primary listing on another exchange.

116 The balance must be made available by the lead broker directly to the 'general public', meaning investors other than clients of the lead broker. The lead broker is responsible for making adequate distribution facilities available.

117 'Connected client' means any client of such member who is a partner, employee, director or substantial shareholder of the lead broker or of any distributors, or the trustee, spouse, infant child or close relative (whose account is managed by such member pursuant to a discretionary managed portfolio agreement) of such person.

118 Listing Rules 10.03 and 10.04.

119 This refers to a fund of investments, the contents of which are kept under review by an Exchange Participant, or any member of the group which such Exchange Participant is a part of, which has authority to effect or arrange for the effecting of transactions for the fund at its discretion.

120 This is consistent with Listing Rules 10.01.

further information for the purpose of establishing their independence and beneficial ownership); and

- The lead broker and each distributor and member of the SEHK involved in the placement must keep a record of their placees for at least three years following the placement.

Thus, as a rule, not more than 10 per cent of the total placement may be offered to employees or past employees of the company or its subsidiaries or associated companies or their dependents on a preferential basis.

Directors and existing shareholders of the company or their associates may only subscribe for or purchase placement shares if the shares are not offered to them on a preferential basis, and no preferential treatment is given to them in the allocation of the shares, and the prescribed public float is maintained. There is no requirement to prepare and maintain an insider list in Hong Kong.

After a company is listed, it may place new shares by way of a rights issue to its existing shareholders. The existing shareholders will subscribe for the new shares, in proportion to their existing holding and usually at a price lower than the prevailing market price of the shares. In addition, a company may implement a dividend reinvestment scheme under which new shares are issued in lieu of cash dividends.

Secondary Dealings

Where the shares for which listing is sought are already listed on another stock exchange, listing by introduction is a method to bring them to the Hong Kong market for a secondary listing. There are generally no marketing arrangements required because the shares for which listing is sought are already of such an amount and so widely held that their adequate marketability when listed can be assumed.[121] The applicant must comply with all the qualifications for listing as set out in the Listing Rules. Listing by introduction will normally be appropriate in the following circumstances:[122]

- The shares for which listing is sought are already listed on another stock exchange;
- The shares for which listing is sought are distributed *in specie*, by a listed company to the shareholders of that listed company or to the shareholders of another listed company; or
- A holding company is formed and the shares for which listing is sought are issued in exchange for those of one or more listed companies.

Listing by introduction will not be permitted if:

- There has been a marketing of the shares in Hong Kong within six months prior to the proposed introduction where such marketing was made conditional upon listing being granted for those shares;

121 Listing Rules 7.13.
122 Listing Rules 7.14.

- There is a pre-existing intention to dispose of shares, a likelihood of significant public demand for the shares or an intended change of the company's circumstances that would render an introduction unacceptable to the SEHK; or
- A change in the nature of the business of the company is in contemplation.[123]

An application for listing by introduction must be supported by a listing document which is compiled in compliance with Chapter 11 of the Listing Rules.[124] The application must state the names and holdings of the 10 largest beneficial shareholders of the shares (if known) and the total number of shareholders. A copy of the share register may be required by the SEHK.[125]

Listing on the SEHK by way of introduction received some attention in November 2009 as a result of the suspension of trading in the shares of Asian Citrus Holdings Ltd, China's biggest orange plantation, just two hours after trading on the opening day following extreme price fluctuations, where the stock opened 7.7 times higher. Market watchers believed that that fluctuation was due to a 10-for-1 share split not being reflected in the data published by the SEHK system.

In June 2010, London-listed insurer Prudential PLC obtained secondary listing in Hong Kong without raising additional funds (as no new shares were issued in Hong Kong). In order for its shares to be transferred expeditiously between the London and Hong Kong stock exchanges, Prudential set up an express shunting process whereby the shares could be transferred from its London registrar to its Hong Kong registrar within three days (which would otherwise take 11 days). The sponsor and underwriters provided liquidity by transferring an undisclosed amount of shares to Hong Kong for trading.

Migration from GEM to Main Board

A streamlined process was introduced in July 2008 which enables GEM Board-listed companies meeting the Main Board listing criteria to migrate to the Main Board without the need to appoint a sponsor or to prepare a prospectus.

The company must have been listed on the GEM for the period at least until the publication of its results for one full financial year following its GEM listing and must not have been subject to any disciplinary investigations by the Exchange in respect of any serious rule breaches in the last 12 months.

Registration

Sponsor Requirement. A new applicant must appoint a sponsor to assist it with its initial application for listing.[126] Only intermediaries holding a valid regulated activity type 6 (advising on Corporate Finance) licence and having met the

123 Listing Rules 7.15.
124 Listing Rules 7.17.
125 Listing Rules 7.16.
126 Listing Rules 3A.02.

on-going eligibility criteria of the SFC Sponsor Guidelines are eligible to be a sponsor. A sponsor also must have at least two Responsible Officers at all times in order to remain eligible to act as a sponsor. The SFC *Corporate Finance Adviser Code of Conduct* sets out the requirements and guidelines for corporate finance advisers, including IPO sponsors.

The sponsor is responsible for preparing the company for listing, lodging the formal application for listing and submitting all supporting documentation to, and dealing with, the SEHK on all matters arising in connection with the application.[127] The sponsor must conduct reasonable due diligence and provide a sponsor's declaration (with various assurances) to the SEHK.[128] The general provisions in respect of the due diligence procedures to be carried out by sponsors are set out in Practice Note 21 of the Listing Rules.

The sponsor also is required to give an undertaking to the SEHK confirming that he will comply with the Listing Rules applicable to sponsors, use all reasonable endeavours to ensure that all information provided to the SEHK is true in all material aspects and does not omit any material information, and cooperate in any investigation conducted by the SEHK. The sponsor will also need to make a statement to the SEHK to declare its independence (and, in the case of joint sponsors, to declare that at least one of them is independent).

The sponsor, or an affiliate of the sponsor, typically participates in the underwriting syndicate and provides advice on the pricing of the shares based on prevailing market conditions before the process begins. The market practice is that underwriting will not be fully committed until approval for listing is granted and days before the start of trading.

Prospectus Liability. In an effort to improve the quality of listings in Hong Kong, the SFC published the "Consultation Conclusions on the regulation of IPO Sponsors" on 12 December 2012. The new sponsor regulation will come into effect on 1 October 2013. The HKEx has made appropriate changes to the Listing Rules and streamlined the listing vetting process to complement the new sponsor regulation.[129] The key features of the new sponsor regulations include:

- Publication of an Application Proof which should be substantially complete on the HKExnews website when a listing application is submitted;
- An eight-week moratorium on listing applications returned on the grounds that the Application Proofs are considered not substantially complete. When applications are returned, the names of sponsors and applicants together with the return date will be published on the HKExnews website;

127 Listing Rules 3A.11.

128 Listing Rules 3A.13.

129 This is because some take the view that sponsors might come under the definition of 'promotors', who are subject to civil liability; or that a sponsor is a person 'who has authorized the issue of the prospectus', subject to civil and criminal liability.

- An accelerated review process for listing applications returned on the grounds that the Application Proofs are considered not substantially complete;
- A streamlined regulatory commenting process focusing on major issues such as eligibility, suitability, sustainability, Listing Rules, CO and SFO compliance and any material disclosure deficiencies; and
- Revised sponsors' rules, undertakings and declarations to complement the Provisions.

Compliance Adviser. The Listing Rules also require a compliance adviser to be appointed post-listing and the sponsor will usually take up this role. The compliance adviser is appointed until the publication of the listed company's accounts for its first full financial year after the date of listing.

The company must seek advice from the compliance adviser if it wishes to undertake certain specific matters such as issuing a regulatory announcement or entering into a notifiable or connected transaction during this period.

Approval for Listing. A new applicant should apply to the SEHK in the prescribed form with the initial listing fee for an advance booking no less than 25 clear days prior to the date on which it is expected that the Listing Committee will meet to consider the application.[130] Under the 'dual filing' system, which establishes the SFC as the statutory regulator of corporate disclosure, the listing applicant also should authorise the SEHK to file the submitted materials with the SFC on its behalf.

The SFC has the right to comment on the listing documents and it has a reserve power to object to a listing application if the information published in the documents is insufficient or misleading. The SFC in practice will not always provide comments on the prospectus but, when it does, it will pass its comments to the sponsor via the SEHK.

Neither the listing document nor any publicity material may be issued until the SEHK has confirmed to the company that it has no further comments. From the submission of the formal application until the time when listing is granted, there must be no dealing in the shares for which the listing is sought by any 'connected person' of the company.[131]

The Listing Rules impose extensive requirements as to the documents which must be submitted to the SEHK for review and approval. In particular, the listing document must not be issued until the SEHK has confirmed to the company that it has no further comments and, once a final proof has been agreed, no material amendment to that proof will be allowed without the consent of SEHK.

130 Listing Rules 9.03(1).
131 Listing Rules 9.09.

False and Misleading Information. Under section 298 of the SFO, it is an offence to disclose or circulate information that is likely to induce the sale or purchase of shares; to maintain or increase the price of the shares if the information is false or misleading as to a material fact; or omit a material fact and the person knows or is reckless as to whether the information is false or misleading. In April 2010, the SFC alleged that Hontex International Holdings Company Limited had:

- Disclosed materially false or misleading information in its IPO prospectus dated 14 December 2009 which was likely to have induced investors to subscribe for and purchase Hontex shares contrary to section 277 and section 298 of the SFO;
- Materially overstated its financial position, as disclosed in its IPO prospectus;
- Provided false or misleading information to the SEHK contrary to section 384 of the SFO; and
- Employed a fraudulent or deceptive scheme in relation to its listing in Hong Kong contrary to section 300 of the SFO.

An interim injunction was obtained to freeze Hontex's assets amounting to HK $997.4 million. The SFC has been seeking orders, under section 213 of the SFO, to restore the funds raised by Hontex in the IPO to those who had subscribed for the shares and those who had purchased shares since the IPO and in either case continue to hold those shares. The High Court (Court of First Instance) in Hong Kong granted an order to require Hontex to make a repurchase offer to investors as a result of its violation of the SFO. The SFC has also revoked the licence of the responsible sponsor and fined it HK$ 42 million for failing to discharge its sponsor's duties in relation to the IPO application of Hontex.

Registration for Listing. Once the listing application and the prospectus have been approved by the SEHK and SFC, the prospectus must then be registered with the Registrar of Companies before being released to the public.

Registration of the prospectus with the Registrar of Companies is a two-stage process involving firstly an application to the SEHK for authorisation for registration followed by an application to the Registrar of Companies for registration. The SEHK must be given at least 14 days' advance notice of the intended date of registration of the prospectus.[132]

Periodic Disclosure

Restrictions on Trading

In General. Restrictions on the trading of shares subsequent to their listing are imposed on the listed company, its directors and (in certain circumstances) its substantial shareholders.[133] Many of these restrictions, together with other

132 Listing Rules 11A.09.
133 Listing Rules 9.15 and Companies Ordinance.

continuing obligations outlined below, are binding on the listed company.[134] Briefly, a listed company is required to:

- Adopt rules governing dealings in listed securities by its directors in terms no less exacting than those contained in the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 to the Listing Rules (discussed below);
- Make application for listing of any securities of the same class as those already listed, prior to the issue of such additional securities; and
- Comply with the Listing Rules and Code on Mergers and Takeovers and the Share Repurchase Code as each is in force from time to time.

In addition, a listed company is required to notify the SEHK:

- Of any change in its authorised representatives;[135]
- Of any allotment of securities for subscription, sale or open offer and the results of any rights issue;
- Of any bonus shares financed out of distributable profits;
- As to certain changes in its issued share capital the day after the event (subject to a *de minimis* threshold and other specified factors);[136]
- Monthly with an update on information relating to its issued share capital and other movements in its securities;[137]
- Of any share interest of directors, the chief executive officer and shareholders exceeding five per cent;
- If its public float falls below 25 per cent (or any lower approved percentage);[138] and
- Of all share repurchase details[139] through the e-submission system.[140]

The Listing Rules also impose an obligation on the listed company to publish an announcement and, in some cases, issue a circular to its shareholders, in a wide range of situations. Announcements are published electronically on the SEHK's website through its e-submission system and on the listed company's own website. Where a circular is required to be issued to shareholders, a copy or summary of such circular must be issued to the holders of any other of the listed company's securities. All circulars must be in English with a Chinese translation.

134 Listing Rules 13.01. Prior to 2004, issuers of equity securities were required to sign such a listing agreement with the SEHK as a pre-condition to listing.
135 Listing Rules 3.05 and 3.06.
136 Listing Rules 13.25A.
137 Listing Rules 13.25B.
138 Listing Rules 13.32.
139 Listing Rules 13.31.
140 Listing Rules 10.32.

A summary of the key events or transactions giving rise to an obligation to publish an announcement or issue a circular is set out in the section headed 'Regulated Market and Compliance with the Listing Rules', below.

In practice, many shareholders hold their shares through a nominee (usually a broker) and very often circulars do not reach the shareholders for their attention. The listed company may notify the nominee to ensure he promptly delivers these circulars to the relevant beneficial shareholders.

Lock-Ins. It is common practice for the controlling shareholders to be subjected to certain lock-in periods upon the shares' first listing. Generally, the controlling shareholders are not allowed:

- Within six months of commencement of dealing, to dispose of, or agree to dispose of, or create any encumbrances in respect of the shares they beneficially own; and
- Within six months after the initial period, to make such disposal or create such encumbrance which would cause them to cease to be the controlling shareholders.

Any offer for sale or secondary offering by the controlling shareholders at the time of the IPO may not be subject to such restriction.[141]

Share Repurchases. A listed company is permitted to buy back or repurchase its own shares on the SEHK or any other stock exchange on which its shares are traded, provided certain conditions are met.

Statutory Provisions for Directors' Dealing. Directors when trading in shares must have regard to Parts XIII (market misconduct), XIV (insider dealing) and XV (disclosure of interests) of the SFO. These requirements are discussed in the section 'Disclosure of Acquisition of Substantial Holdings', below.

Model Code for Directors' Dealing. The listed company must adopt rules governing dealings in securities by its directors, such rules to be no less exacting than the rules set out in the Model Code for Securities Transactions by Directors of Listed Issuers in Appendix 10 of the Listing Rules. The listed company can, if it wishes to, simply adopt the Model Code as its own rules. The Model Code sets out the standards against which directors must measure their conduct when trading in the shares of the listed company. The Model Code aims to supplement the statutory provisions of the SFO relating to insider dealing by preventing directors and employees who are likely to be in possession of material information from dealing in shares.

Under the Model Code, directors are required to refrain from dealing in any securities of the listed company whenever they are in possession of unpublished

141 Listing Rules 10.07.

price-sensitive information in relation to those securities. Directors who are aware of or are privy to any negotiations or agreements related to intended acquisitions or disposals which are notifiable transactions under Chapters 14 and 14A of the Listing Rules or which are or may be price-sensitive should refrain from dealing in the listed company's securities as soon as they become aware of them or privy to them up to the formal announcement of the information. Those directors who are not so privy should be cautioned that there may be price-sensitive information and that they should not deal in the listed company's securities for a similar period.

If a director wishes to trade his shares where such sale is prohibited but exceptional circumstances exist (such as a pressing financial commitment), the director must satisfy the chairman (or other nominated director) of the listed company that the circumstances are exceptional and that the proposed sale is the only reasonable course of action available to the director.

The Exchange must be notified of the sale and the listed company must publish an announcement immediately after the sale stating that the chairman (or other nominated director) was satisfied that there were exceptional circumstances for such sale.

Suspension and Resumption of Trading. A listed company may request a suspension of trading of its shares, or the SEHK may enforce a suspension of trading in a listed company's shares in certain circumstances. The listed company must support its request for trading suspension with sound reasons.[142] This request will not necessarily be granted, particularly if the publication of an announcement would suffice. The circumstances in which a request for suspension will normally be granted are set out in Practice Note 11 of the Listing Rules.

The SEHK may direct a trading halt or suspend trading or cancel a listing where necessary for the protection of investors or in order to maintain an orderly market. The SEHK may intervene as it thinks fit, including where: (i) the listed company materially breaches the Listing Rules; (ii) the listed company has insufficient public float; (iii) the listed company has insufficient operations or assets; or (iv) if it is no longer suitable for listing.[143] The procedure for lifting a suspension will depend on the circumstances. Generally, the halted or suspended company will need to make a written request to resume trading.[144]

Regulated Market and Compliance with the Listing Rules

In General. Listed companies in Hong Kong are subject to detailed compliance requirements set out in Chapters 14 and 14A of the Listing Rules[145] in relation to

142 Listing Rules 6.02.
143 Listing Rules 6.01.
144 Listing Rules 6.04.
145 The HKEx recently streamlined the circular and listing document requirements as a result of a consultation process. The new Listing Rules in respect of these requirements came into effect on 3 June 2010. The rules mainly deal with financial

certain acquisitions, disposal or realisations and in relation to transactions between the listed company and any connected person.[146] It is important to highlight the responsibility of directors in disclosing these transactions. The extent of a director's duty in preparing relevant disclosures is highlighted in the responsibility statement that must be included in all notifiable and connected transaction circulars and the listing document (as well as in all announcements in respect of GEM Board-listed companies):

> 'This document, for which the directors of the issuer collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to the issuer. The directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in this document is accurate and complete in all material respect and not misleading or deceptive,[147] and there are no other matters the omission of which would make any statement herein or this document misleading.' (emphasis included)

The following paragraphs outline the key features relating to compliance with the Listing Rules by listed companies in Hong Kong. The SEHK undertakes a continuous review of the Listing Rules.

Statutory Backing of the Obligation to Disclose Price Sensitive Information. The SFO was amended to implement statutory obligation to disclose inside information in 2012[148] to ensure an orderly, informed and fair market.[149] As a result of this implementation, the Listing Rules were amended to remove the existing continuing disclosure obligations which have formed part of the statutory regime. The Inside Information Provisions (Part XIVA of the SFO) impose statutory obligations on the listed issuer and their directors to disclose inside information as soon as reasonably practicable after the information has come to the listed issuer's knowledge, and gives the SFC the responsibility to enforce these obligations. A concept of 'trading halt' has also been introduced, which is an interruption of trading in the issuer's securities requested or directed pending disclosure of information under the Listing Rules and extending for no more than two trading days.

Classification of Transactions. Chapter 14 of the Listing Rules classifies transactions into six threshold levels set out below. Listed companies must

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and non-financial disclosures in and the despatch of these documents. This chapter incorporates these amendments effective 3 June 2010.

146 'Connected Person' is defined under chapters 1.01 and 14A.11 of the Listing Rules.

147 This is introduced in the revised Listing Rules effective 3 June 2010 imposing a responsibility for directors to ensure all disclosures are not misleading or deceptive. Prior to these amendments, the directors are only required to state that they have made all reasonable enquiries and to the best of their knowledge and belief.

148 Securities and Futures Ordinance, s 21.

149 Listing Rules 13.05.

consider all the percentage ratios in classifying a transaction (commonly referred as the 'Five Tests'):[150]

- **Assets ratio** — the total assets which are the subject of the transaction divided by the total assets of the listed company;
- **Profits ratio** — the profits attributable to the assets which are the subject of the transaction divided by the profits of the listed company;
- **Revenue ratio** — the revenue attributable to the assets which are the subject of the transaction divided by the revenue of the listed company;
- **Consideration ratio** — the consideration divided by the total market capitalisation of the listed company. The total market capitalisation is the average closing price of the listed company's shares as stated in the SEHK's daily quotations sheets for the five business days immediately preceding the date of the transaction; and
- **Equity capital ratio** — the nominal value of the listed company's issued share capital issued as consideration divided by the nominal value of the listed company's issued share capital immediately before the transaction.

The following table summarises the different transactional threshold levels based on the Five Tests and the corresponding compliance requirement by the listed company and its directors regarding notification, publication and shareholder approval for each level:[151]

	Threshold Level of each of the Five Tests Ratio	Notification to Exchange/ Publication of Announcement in accordance w/Rule 2.07C	Circular to Shareholders within 21 days of Announce-ment	Independent Shareholder Approval[152]	Accountant Report
Share transaction	Less than five per cent	Yes	No	No (unless shares are not issued under a general mandate)	No
Disclosable transaction	Five per cent or more, but less than 25 per cent	Yes	No	No	No
Major transaction	25 per cent or more, but less than 75 per cent for disposals or less than 100 per cent for acquisitions	Yes	Yes	Yes	Yes

150 Listing Rules 14.07.
151 Listing Rules 14.33.
152 Any shareholder and his associates must abstain from voting if such shareholder has a material interest in the transaction.

Very substantial disposal	75 per cent or more	Yes	Yes	Yes	No
Very substantial acquisition	100 per cent or more	Yes	Yes	Yes	Yes
Reverse takeover[153]	A very substantial acquisition which involves either a change of control or the acquisition of assets from a person who has gained control of the listed company within the last 24 months	Yes	Yes	Yes	Yes

Connected Transactions. A connected transaction generally refers to a transaction between a listed company or its subsidiaries and a connected person.[154]

The basic principle is that a connected transaction is subject to both disclosure and shareholder approval requirements unless it is governed by a specific exemption or relaxation, or the SEHK is prepared to grant a waiver.

The following are examples of connected transactions that are exempted from reporting, announcement and independent shareholders' approval:

- A transaction between a listed company and a non-wholly owned subsidiary or between its non-wholly owned subsidiaries where no connected persons of the listed company (other than at the level of its subsidiaries) are (individually or together) entitled to exercise, or control the exercise of, 10 per cent or more of the voting power at any general meeting of any of the subsidiaries concerned and none of the subsidiaries concerned is itself a connected person;[155]
- A transaction between a listed company's non-wholly owned subsidiary and any of its subsidiaries which are connected persons only by virtue of being the subsidiaries of the non-wholly owned subsidiary; or a transaction between any of these subsidiaries;[156]
- Connected transactions under the *de minimis* exemption[157] from disclosure, reporting and independent shareholders' approval;

153 Listing Rules 14.06(6).
154 See definition in footnote 55, above.
155 Listing Rules 14A.31(1).
156 Listing Rules 14A.31(1A).
157 A connected transaction is exempt from the shareholders' approval requirement if the transaction is on normal commercial terms and each of the size tests (except for the

- Issue of shares by the listed company or its subsidiaries to a connected person where such issue is simply *pro rata*, or is made under an approved share option scheme, or the connected person is acting as an underwriter (provided certain provisions under the Listing Rules have been complied with), or is made within 14 days after such connected person has executed an agreement to reduce its holding in the class of securities by placing securities to a third person who is not its associate at a price not less than the placing price;[158]
- A dealing in securities listed on the SEHK or a recognised stock exchange by the listed company in the ordinary and usual course of business (subject to certain qualifications);[159]
- An open-market purchase by a listed company of its own securities from a connected person on the SEHK or a recognised stock exchange or under a general offer made in accordance with the Share Repurchase Code. Where the purchase is made on the SEHK or a recognised stock exchange, this exemption will not apply if the connected person knowingly sells its securities to the listed company;[160]
- The entering into of a service contract with a director of the listed company or its subsidiaries (although pursuant to Listing Rules 13.68 there are circumstances where this would require independent shareholders' approval);[161]
- The acquisition as consumer or realisation in the ordinary and usual course of business of consumer goods or consumer services by a listed company or its subsidiaries from or to a connected person on normal commercial terms (subject to certain qualifications);[162]
- The sharing of administrative services between a listed company or its subsidiaries and a connected person on a cost basis. The cost of the services (examples include company secretarial services, legal services and staff training services) must be identifiable and allocated to the parties involved on a fair and equitable basis;[163]
- Transactions between the listed company or its subsidiaries and a connected person only so connected by virtue of his relationship with an 'insignificant subsidiary';[164] and

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profits test) is less than 5 per cent or each of the size tests (except for the profits test) is equal to or more than 5 per cent but less than 25 per cent and the consideration is less than HK $10 million. (Listing Rules 14A.31(2) and 14A.32).

158 Listing Rules 14A.31(3).

159 Listing Rules 14A.31(4).

160 Listing Rules 14A.31(5).

161 Listing Rules 14A.31(6).

162 Listing Rules 14A.31(7).

163 Listing Rules 14A.31(8).

164 A subsidiary is 'insignificant' if: (i) the values of its total assets, profits and revenue represent less than 10 per cent of the listed company's total assets, profits and revenue

- The involvement of an associate of a substantial shareholder of the listed company, where the substantial shareholder is a passive investor in the listed company and meets certain other specified criteria.[165]

Where the connected transaction is subject to independent shareholders' approval, an independent financial adviser must be appointed to advise the independent board whether the transaction is fair and reasonable and in the interests of the listed company and its shareholders as a whole.[166]

Continuing Connected Transactions. These are connected transactions involving the provision of goods or services, or financial assistance, that are repeated and are not one-off in nature. Certain continuing connected transactions are exempted from reporting, annual review, announcement and independent shareholders' voting requirements, including the provision of consumer goods or consumer services, the sharing of administrative services and continuing connected transactions under the *de minimis* exemption.

Continuing connected transactions must meet the exemption conditions at the time of each transaction in order for the listed corporate group to be exempted from the connected transaction requirements. If a connected transaction no longer qualifies for the exemption for any reason, the listed company must comply with all applicable connected transaction requirements for subsequent continuing transactions.

Timing of Disclosure. A listed company is obliged to make disclosure as soon as reasonably practicable of information which:

- Is necessary to enable the SEHK, members of the listed company, other holders of the listed company's securities and the public to appraise the position of the group; or
- Is necessary to avoid the establishment of a false market in its securities; or
- Might reasonably be expected to materially affect market activity in and the price of its securities.[167]

If an announcement requires pre-vetting by the Listing Division, the listed company must not submit that announcement for publication until clearance, by way of the usual indication that the SEHK has 'no further comments', has been obtained.

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based on the accounts for each of the latest three financial years (or, if less, the period since the establishment of the subsidiary); or (ii) the values of its total assets, profits and revenue represent less than five per cent of the issuer's total assets, profits and revenue based on the accounts for the latest financial year. The issuer can change from the one-year test to the three-year test (or vice versa) from time to time (Listing Rules 14A.31(9)(b)).

165 Listing Rules 14A.31(10).

166 Listing Rules 14A.21.

167 Listing Rules 13.09(1).

Suspended Companies. Trading in the securities of a listed company may be halted or suspended by the SEHK for failure to make an announcement on the HKEx website on a subject matter that is material and price-sensitive.[168]

This is consistent with the principle set out in Chapter 6 of the Listing Rules, that suspension is imposed where the SEHK considers it necessary for the protection of investors or the maintenance of an orderly market. Listed companies whose shares had been halted or suspended from trading for three months or more are summarised in the Prolonged Suspension Status Report on the HKEx website.

Public Disclosures

In General. Free trade is dependent to a large extent on the accessibility and free flow of information within the market itself, and the prevention of improper market practices. This section discusses how exchange of information is promoted within the marketplace and improper market practices are prevented.

There is a general obligation imposed on the listed company by the listing agreement to keep the SEHK, its shareholders, and holders of its debt securities listed on the SEHK informed.[169]

Disclosure of Price-Sensitive Information. Under the Listing Rules, any price-sensitive information must be disclosed by way of an announcement. 'Price-sensitive information' is not defined in the Listing Rules, but the SEHK has indicated that it generally refers to information that:

- Is necessary to enable shareholders and the public to appraise the position of the group;
- Is necessary to avoid the establishment of a false market in its securities; and
- Might be reasonably expected materially to affect market activity in and the price of its securities.[170]

The Amendment Ordinance creates a new Part XIVA of the SFO, under which a corporation listed on the SEHK is under a statutory obligation to disclose inside information to the public as soon as reasonably practicable. Any breach of that obligation would expose the listed corporation and/or its officer(s) to the risk of civil sanctions, as well as liability to compensate those who have suffered pecuniary losses as a result of the breach. The statutory disclosure regime will take effect on 1 January 2013.

168 Listing Rules 13.09.

169 Note that the requirement for listing agreements when listing of equity securities was repealed in 2004.

170 This definition was included in the listing agreement applicable to equity listing applicants pre-2004. It also is in the 'Guide on disclosure of price-sensitive information' published by the SEHK in January 2002.

Publication of Announcements, Circulars and Other Documents. The general principles set out in the Listing Rule [171] require listed companies to keep price-sensitive information (including financial results) confidential until a formal announcement is made, and discourage selective disclosure of price-sensitive information. There also is a specific requirement for the directors of listed companies relating to approved financial results and dividends approved at board meetings:

> ‘ . . . The directors are reminded that it is their direct responsibility to ensure that such information is kept strictly confidential until the announcement is made.’ [172]

Under the Listing Rules, the release of information can be made by way of a formal announcement on the HKEx website, which is regarded as the formal channel of communication with the investing public. Listed companies should release such a formal announcement before the dissemination of financial results at a press conference or analysts’ meeting. The following is a summary of the requirements for announcements and circulars set out in the Listing Rules.

Summary of Disclosures Requirements under Hong Kong Listing Rules

	Announcement on HKEx Website	Circulars to Shareholders
Price-sensitive information	• Any price-sensitive information • Material price-sensitive litigation claim against the listed company or its subsidiaries (or made by the listed company or its subsidiaries against a 3rd party).	• Not required
Share transactions and other transactions	• Any notifiable share or other transaction (Listing Rules Chapter 14).	• Not required
Connected share and other transactions	• Any connected share or other transaction (unless an exemption is available) (Listing Rules Chapter 14A). • Advances and financial assistance to third parties — when the financial assistance exceeds the eight per cent under the assets ratio defined under Listing Rules 14.07(1) (Listing Rules 13.13).	• Required, unless one of the exemptions applies (Listing Rules 14A.49).

171 Listing Rules, Ch 2 and Listing Rules 13.09.
172 Note 1 to Listing Rules 13.45.

	• Loan agreements — when the listed company enters into a loan agreement which imposes performance obligations on any controlling shareholder (Listing Rules 13.18) or when the listed company breaches any significant term of a loan agreement (Listing Rules 13.19).	
Takeover offers	• As soon as the listed company makes or receives a takeover offer.	• Required
Accounts and auditors[173]	• Annual and interim accounts (Listing Rules 13.49). • Any change of auditors (Listing Rules 13.51). • Any change in the financial year end (Listing Rules 13.51).	• Not required except for the published annual and interim accounts.
Company name change	• Required	• Required (as shareholders' approval is required under Companies Ordinance s 22.)
Dividend	• Required	• Required, the annual report can serve as the circular (see Articles of Association)
Changes to Memorandum and Articles of Association	• Required	• Required (shareholders' approval required for Hong Kong-incorporated company (CO ss 8,13))
Other corporate matters	• Change to Registered Office	• Withdrawal of listing (Listing Rules 6.11/6.12).

173 Listing Rules 13.88 require shareholder approval for the removal of an auditor before the end of its term of office — the issuer will be required to send a circular to shareholders with any written representations from the auditor to the shareholders and the auditor must be permitted to make written and verbal representations at the general meeting.

Corporate governance	• If the listed company fails to set up an audit committee or does not meet the membership requirements (Listing Rules 3.23).	• Not required
Directors and Officers	• On the appointment or resignation of any director (Listing Rules 13.51). • Receipt of director nomination after a general meeting notice has been issued (Listing Rules 13.70). • If the listed company breaches the requirement for a minimum number of INEDs (Listing Rules 3.11). • At least seven clear business days before any board meeting to declare a dividend or approve the annual or interim accounts (Listing Rules 13.43) and must notify the Exchange of the results of such meeting (Listing Rules 13.45). • Once a board decision to change the company secretary has been made (Listing Rules 13.51). • Resignation, termination, or change of the compliance adviser (Listing Rules 3A.29/13.51). • Director undergoes bankruptcy or related proceedings or in certain circumstances suffers public sanction, conviction, investigation, or is made a defendant in criminal proceedings (Listing Rules 13.51B). • Loans to directors (if permitted) (Listing Rules 14A.47).	• Loans to directors – if classified as a connected transaction (Listing Rules 14A.49). • Receipt of director nomination after a general meeting notice has been issued (Listing Rules 13.70). • Service contracts (if shareholders' approval is required) (Listing Rules 13.68/Listing Rules 13.69).

	• If a director sells shares when otherwise prohibited from doing so under the Model Code, but exceptional circumstances exist and sale is approved by the chairman (Appendix 10, paragraph 14).	
Shares	• 14 days before the register of members or transfer book is closed (Listing Rules 13.66). • If the listed company intends to make a bonus issue (Listing Rules 13.09). • Certain changes in the issued share capital (in the prescribed manner) on the day after the event (Listing Rules 13.25A). • Monthly update on information relating to its issued share capital and other movements in its securities (Listing Rules 13.25B). • If the listed company proposes to issue convertible securities, warrants and options (Chapters 14 and 14A of the Listing Rules, or Listing Rules 13.28, Listing Rules 13.09). • Share interests of any director, the chief executive and any shareholder exceeding five per cent of issued share capital (of the Securities and Futures Ordinance Part XV). • Issue of shares and changes to the issued share capital upon exercise of share options (Chapters 14 and 14A, Listing Rules 13.28, Listing Rules 13.09).	• Bonus/capitalisation issues (Listing Rules 7.29). • Issue of convertible securities, warrants and options and issue of shares if shareholders' approval is required or if made as part of a notifiable or connected transaction (Listing Rules 13.36, Listing Rules 14A.49). • Issue of shares by subsidiaries so as to materially dilute the percentage equity interest of the listed parent company in the subsidiary. • Adopting a new employee share option scheme that requires shareholders' approval and further grants of options to directors, the chief executive or substantial shareholders or their associates that require shareholders' approval (Listing Rules 17.04).

	• Issue of shares by subsidiaries so as to materially dilute the equity interest of the listed parent company (Listing Rules Chapter 14 or Listing Rules 13.09). • New employee share option scheme requiring shareholders' approval and the granting of options under the scheme (Listing Rules 17.02, 17.06A). • Placement of new shares for cash (Listing Rules 13.28). • Share repurchases (Listing Rules 13.31) (Listing Rules 10.06). • Any rights issues and open offers (Listing Rules 13.09).	• Share repurchases where the directors' general mandate must be approved by shareholders each year and where additional explanatory statement on any repurchase mandate must be included in the annual report or a separate circular (Listing Rules 10.06). • Rights issues and open offers.
Shareholder relations	• Pledging of shares by controlling shareholder (Listing Rules 13.17). • Shareholders' meetings and communications – the listed company must publish a copy of its AGM notice (Listing Rules 13.37) and notices of extraordinary or special meetings (Listing Rules 2.07C) in its announcements.	• Shareholders' meetings and communications – an AGM will have its accompanying annual report, repurchase mandate disclosures and any other explanatory statements needed for any special business agenda. For other general meetings some form of circular will always be required to accompany the notice of meeting.

Announcements and Distribution of Interim and Annual Reports. Every listed company must issue, as a minimum, full-year financial results and six-monthly interim financial results. The listed company also must publish its annual and interim financial results by way of an announcement.

The announcement must be published as soon as possible and in any event not later than 30 minutes before trading on the day after the financial results are approved

by the board of the listed company.[174] The SEHK will normally require suspension of trading if the listed company fails to publish its financial results on time.[175]

The listed company must then send its annual report and accounts (or a summary financial report) to all its shareholders not less than 21 days before its AGM and in any event not more than four months after the end of its financial year. Every listed company also must send its six-monthly interim accounts (or a summary interim report) to all its shareholders not later than three months after the end of the interim period.

The annual report and interim report must comply with Appendix 16 and also must contain other disclosures required by the Listing Rules. Slightly modified rules apply to foreign and PRC-incorporated companies. One copy must be sent to the SEHK.[176] It is a recommended best practice under the Code on Corporate Governance Practice that the listed company also publishes quarterly financial results. Quarterly reporting is not required except for dual-listed PRC-incorporated companies where quarterly reporting is mandatory in the PRC as well as for companies listed on the GEM board.

Preparation of Annual Accounts and Auditors' Report. The accounting standards applicable are 'best practices' which are at least those required to be complied with in respect of specific matters in the accounts of a company incorporated under the Companies Ordinance and the Hong Kong Financial Reporting Standards (HKFRS) or the International Financial Reporting Standards (IFRS) (and, if applicable, the China Accounting Standards for Business Enterprises) and, in the case of banking companies, the Financial Disclosure by Locally Incorporated Authorised Institutions issued by the Hong Kong Monetary Authority.[177]

Auditors' Liability. Section 399 of the New CO provides an offence for an auditor to 'knowingly or recklessly' cause to be omitted from the auditor's report any of the information required including:

- The opinion that adequate accounting records have not been kept by the company;

174 Under Listing Rules 13.49, the listed company must publish its full year results the business day after they are approved by the board and in any event: (i) for annual accounting periods ending before 31 December 2010 — not later than four months after the end of the financial year; or (ii) for annual accounting periods ending on or after 31 December 2010 — not later than three months after the end of the financial year. In the case of interim results, the listed company also must publish its interim results the business day after they are approved by the board and in any event: (i) for half-year accounting periods ending before 30 June 2010 — not later than three months after the end of that period of six months or (ii) for half-year accounting periods ending on or after 30 June 2010 — not later than two months after the end of that period of six months.

175 Listing Rules 13.50.

176 Listing Rules 13.46-47.

177 Listing Rules 4.10.

- The opinion that financial statements are not in agreement with the accounting records, in any material respect; and
- The fact that all the information or explanations, to the best of the auditor's knowledge and belief, which are necessary and material for the purpose of the audit, have not been obtained.

Anti-Money Laundering. The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ('AMLO') came into effect on 1 April 2012, and affects financial institutions regulated by SFC, HKMA and the Hong Kong Insurance Authority. A financial institution (and any employee of such financial institution) that knowingly contravenes the AMLO may be liable to a fine of HK$1 million and imprisonment for two years.[178] The relevant authorities may also publish specific guidelines under the AMLO.[179] Under the AMLO, financial institutions are required to ensure that they have effective systems and controls to provide reasonable assurance to the regulators that they can avoid aiding and abetting money launderers, financial criminals and terrorist financers. Financial institutions will need to demonstrate that they have adequate customer due diligence (CDD) procedures, which include adopting a risk-based approach that requires enhanced CDD in respect of higher risk customers. In addition, financial institutions will need to undertake ongoing transaction monitoring to identify and report suspicious transactions.

Takeovers Code. The Code on Takeovers and Mergers (Takeovers Code) issued by the SFC applies to all takeover and merger activities affecting public companies in Hong Kong and companies with primary equity listings in Hong Kong.

The Listing Rules oblige all listed companies to comply with the Takeovers Code.[180] The Code prescribes the contents of the announcement of a firm intention to make a takeover offer. The listed company must submit to the SEHK draft copies of any documents issued in connection with a takeover offer[181] (see further discussion in section headed 'Public Takeover Bids', below).

Share Repurchases. A share repurchase is an offer made by or on behalf of a listed company to purchase, redeem, or otherwise acquire its own shares from any existing shareholders. Such acquisitions are subject to the restrictions and notification requirements of the Listing Rules,[182] the Code on Share Repurchases (Share Repurchase Code) and the Companies Ordinance, depending on the company in question.

Section 49B of the Companies Ordinance allows a Hong Kong incorporated company to purchase its own shares provided it complies with the provisions of

178 AMLO, ss 5(5) and 5(7).
179 AMLO, s 7.
180 Listing Rules 13.23(2).
181 Listing Rules 13.52(1).
182 See share repurchase guidelines under Listing Rules 10.06.

this section. A listed company is permitted to purchase its own shares on the SEHK provided the purchase is authorised by the shareholders in a general meeting. This authority is generally granted by the shareholders at each AGM at the same time as the directors' general mandate is approved.

The Share Repurchase Code must be complied with by all public companies in Hong Kong as well as all companies with a primary listing on the SEHK and provides that a public or listed company may only engage in share repurchases either by way of:

- An on-market share repurchase made in accordance with the Listing Rules;
- An off-market share repurchase approved in accordance with the Share Repurchase Code by the SFC and after an approval vote by disinterested shareholders;
- An exempt share repurchase; or
- A share repurchase by general offer in accordance with the Share Repurchase Code and the Takeovers Code.

Issuers with Primary Listing in Hong Kong

Prior to 2004, all applicants were required to enter into a listing agreement with the SEHK as a pre-condition to listing debt and equity securities.

The listing agreement is designed to ensure that subsequently listed companies keep shareholders and the public fully informed of any matters which might affect their interests. Since 2004, the requirement for listing agreements no longer applies to the listing of equity securities.[183]

Dual-Listed Companies

Simultaneous Release of Information. Where a foreign company is listed on more than one exchange, it is required to ensure that the same information which is required to be disclosed to the SEHK and the market in Hong Kong is released at the same time it is released to any other stock exchanges or markets. This requirement includes any information released by a subsidiary of the issuer to another stock exchange if that information is material to the issuer.[184] In reality, compliance with this requirement is hampered by time differences between Hong Kong and many major markets.

Where the foreign company's primary listing is on a stock exchange in a different time zone, the SEHK will allow an announcement to be made in Hong Kong on the date immediately after the release of information in the primary market, provided that the announcement is made before dealing commences in Hong Kong on that day. If the foreign company's primary listing is in Hong Kong, then the

183 Although it still applies to the listing of debt securities. See Listing Rules Appendix 7.

184 Listing Rules 13.09(1). See HKEx letter re "New guidelines on publication of overseas regulatory announcements", dated 21 January 2011.

announcement should be made in Hong Kong first followed by an announcement in the overseas market before it opens for trading. The obligation to ensure simultaneous release of information in all markets in which a listed company's securities are traded can be onerous, and has caused compliance problems for multinational companies.

The duty to ensure simultaneous disclosure applies where information is required to be released by a listed subsidiary to another stock exchange and the information in question also is required to be disclosed by the listed parent company in Hong Kong.

Annual Accounts. Where a foreign company's primary listing is on the SEHK, its annual accounts must comply with the accounting standards applicable to Hong Kong companies. In addition, the accounts must be audited to a standard comparable to that required by the Hong Kong Institute of Certified Public Accountants or by the International Auditing and Assurance Standards Board of the International Federation of Accountants (or China Auditing Standards Board of the China Ministry of Finance, as applicable).[185]

The same auditor's qualification applies as those required for the initial public offering. The foreign company will be required to prepare its annual report, annual accounts and auditors' report in English, accompanied by a Chinese translation. Where the foreign company's primary listing is on another stock exchange, there is no requirement to produce a Chinese translation of its financial reports.[186]

Repurchase of Shares. A foreign company which has listings on more than one stock exchange will be required to state in its annual accounts particulars of any purchase, sale or redemption of its own listed securities made on the SEHK and on any other stock exchange.

Such statement must include the aggregate price paid or received by the foreign company for such purchase, sale or redemption and should distinguish between those securities purchased or sold on the SEHK and on any other stock exchange. An appropriate negative statement should be made where no such purchase, sale or redemption has been made.

Directors' Remuneration. A foreign company is required to provide the same information relating to directors' emoluments, pensions and any compensation in respect of loss of office that is required to be provided by a Hong Kong incorporated company pursuant to sections 161 and 161A of the Companies Ordinance.

Such information will include details relating to directors' fees, salaries, other benefits and the corresponding amounts for the preceding financial year. The foreign company also is required to disclose details relating to any discretionary or

185 Listing Rules 19.48.
186 Listing Rules 19.19.

performance-related bonus, contributions made on behalf of directors to pension schemes and any (contractual or other) compensation paid to directors for the loss of office.

Compliance with Hong Kong Companies Ordinance. While the Companies Ordinance does not apply to companies which are incorporated outside Hong Kong, the Listing Rules require a foreign company to comply with certain provisions of the Companies Ordinance, including the tenth schedule and section 129D (preparation of accounts and contents of the directors' report), sections 128 and 129A (details of its subsidiaries and ultimate holding company), sections 161, 161B, 162 and 162A (details relating to directors' remuneration, loans to company officers, directors' interest in contracts and management contracts) and section 129A (details of investments).[187]

Hong Kong Depositary Receipts

The SEHK introduced a framework to enable foreign companies to list Hong Kong depository receipts (HDRs) on the Main Board. HDRs may be a convenient alternative listing method for foreign companies whose home jurisdiction discourages overseas listing of shares or otherwise restricts a company pursuing a traditional share listing.

The Main Board listing criteria generally apply equally to HDRs, with some additional requirements and modifications set out in Chapter 19B of the Listing Rules. A foreign company intending to issue HDRs in Hong Kong will still need to satisfy the SEHK that its jurisdiction of incorporation provides for shareholder protection equivalent to that in Hong Kong and the criteria set out in the joint policy statement regarding the suitability for listing of foreign companies. The HDRs must be freely tradable and the underlying shares must be free from restrictions on transfer by the depositary.

The foreign company will need to appoint a depositary acceptable to the SEHK. The depositary must be a suitably authorised and regulated financial institution which the SEHK considers has suitable experience in issuing and managing depositary receipts programmes in Hong Kong or overseas.[188] The depository will issue the depositary receipts as the agent for the foreign company.[189] The foreign company will need to enter into a deposit agreement with the depositary which complies with the SEHK requirements, including that the depositary hold the shares in the foreign company on trust for the sole benefit of the HDR holders.[190]

The depositary must maintain a register of HDR holders through an approved Hong Kong share registrar. The foreign company also must ensure the continued

187 Listing Rules, Appendix 16.
188 Listing Rules 19B.15.
189 Listing Rules 19B.05.
190 Listing Rules 19B.16.

suitability of the depositary,[191] and that the depositary performs its obligation under the deposit agreement and the Listing Rules and that the rights of the HDR holders are fully recognised and equivalent to the rights of its overseas shareholders.

Trading Rules and Market Conduct

Securities Offering

Offer

In General. In Hong Kong, the SFC is the regulatory body which supervises public offers of securities. The SFC is responsible for considering the statements in prospectuses or other promotion documents. Public offerings of company shares or debentures have to satisfy disclosure requirements under the Companies Ordinance and of the SFO. Listed companies also must satisfy the requirements under the SEHK rules. The prospectus requirements have already been discussed above (See 'Securities Offering — Prospectus Requirements').

For a company incorporated in Hong Kong, no prospectus must be issued by or on behalf of such company unless the prospectus complies with the requirements of the Companies Ordinance and, on or before the date of its publication, its registration has been authorised under section 38D(1) of the Companies Ordinance.

For a company incorporated outside Hong Kong (whether or not the company has an established place of business in Hong Kong), no prospectus offering for subscription or purchase of shares in or debentures of such a company may be issued, circulated or distributed in Hong Kong unless the prospectus complies with the requirements of the Companies Ordinance, its registration has been authorised under section 342C of the Companies Ordinance, and a copy of the prospectus has been registered with the Hong Kong Registrar of Companies before it could be issued, circulated or distributed.[192]

The Securities and Futures and Companies Legislation (Structured Products Amendment) Ordinance 2011, which took effect on 13 May 2011, passed the regulation of the public offers of structured products in the form of shares or debentures from the prospectus regime of the Companies Ordinance to the regime for public offers of investments under the SFO. Under the new regime, advertisements and offer documents for all structured products that are publicly offered must be authorised by the SFC, unless otherwise exempted by the SFO.

Offer Exemptions. The Companies Ordinance was amended on 3 December 2004 to provide for 12 exempted types of offers (or safe-harbours) where any

191 Listing Rules 19B.17.
192 Companies Ordinance, s 342C(1).

document issued relating to such an offer does not constitute a 'prospectus'. These exemptions[193]are listed in Schedule 17 to the Companies Ordinance, as follows:

- Professional investors' exemption (ie, offer made to 'professional investors');[194]
- Limited number of persons exemption (ie, offer made to not more than 50 persons);
- Small-scale offer exemption (ie, total consideration payable under offer does not exceed HK $5 million);
- Minimum consideration/denomination exemption (ie, offer under which the minimum denomination of shares is not less than HK $500,000);
- Invitation in good faith to enter into underwriting agreements;
- Codes-related documents (ie, documents relating to the Code on Takeovers and Mergers and Code on Share Repurchases);
- Bonus or scrip issue exemption (ie, offer of shares for no consideration or as an alternative to dividend);
- Employee option exemption (ie, offer of shares to employees); and
- Other types of exemptions (eg, offers by charitable institutions or educational establishments, offers to members of a club, offers in respect of an exchange of shares in the same company and offers in connection with collective investment schemes).

Certain of the exemptions require a warning statement specified in Part 3 of Schedule 18 to the Companies Ordinance, which should be included in the offer document. If such warning statement is not contained, the prospectus exemption cannot be relied upon.[195]

Public

In General. When an application form to apply for shares or debentures of a company is issued, it must be accompanied by a prospectus that complies with the requirements under the Companies Ordinance, unless such application form is not issued to the public.[196]

Hence, whether the shares or debentures are offered to the public is crucial as to whether a prospectus is required to be prepared (which is an expensive task). The word 'public' is given a very wide meaning under the Companies Ordinance. Under section 48A of the Companies Ordinance, 'public' includes a reference to:

193 These are modelled closely to the UK Financial Services and Markets Act 2000.

194 'Professional investors' is defined in section 1, Part 1, Schedule 1 to the Securities and Futures Ordinance, and section 3 of the Securities and Futures (Professional Investor) Rules.

195 These are modelled closely to the UK Financial Services and Markets Act 2000.

196 Companies Ordinance, s 38(3).

> '. . . any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner.'

The last part of the definition is generally taken to mean that the word 'public' also refers to persons selected as a class in any other manner. The meaning of 'public' is not restricted to persons within Hong Kong.

Under section 48A(2) of the Companies Ordinance, an offer or invitation to the public will not be treated as made to the public if it can properly be regarded, in all the circumstances, as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or if it can be properly regarded as otherwise of domestic concern to the persons making and receiving it.[197]

Under section 343(2) of the Companies Ordinance, an offer of shares or debentures for subscription to any person whose ordinary business is to buy or sell shares (whether as principal or agent) may not be deemed an offer to the public.[198]

The above exemptions (commonly known as 'domestic concern exemption' and 'professional's exemption') are independent of the 12 safe-harbour exemptions in Schedule 17 of the Companies Ordinance. Hence, to be an exempted offer, it may either be an offer not made to the public, or fall within the safe-harbours in Schedule 17 to the Companies Ordinance.

Although there is little direct Hong Kong judicial authority regarding section 48A of the Companies Ordinance, there is a wealth of relevant English and other case law.[199] While a detailed review of such case law will not be pursued here, it can be fairly said that there are no clear criteria for determining whether an offer or invitation addressed to a group of people constitutes an offer to a section of the public. However, practitioners generally suggest that the following factors will be taken into consideration:

- Number of offerees comprising the group, with between 20 and 50 offerees being usually recommended;

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197 Companies Ordinance, s 48A(2). This is commonly known as the 'domestic concern exemption' and has been generally constructed as constituting an exemption for offers to employees.

198 This is commonly known as the 'professional's exemption'.

199 See *Lee v Evans* (1964) 112 CL Rules 276; *Government and Stock and Other Securities Investment Co Ltd v Christopher* (1956) 1 W Listing Rules 237; *Re South of England Natural Gas Petroleum Co Ltd*, 1 Ch 573; *Corporate Affairs Commission (NSW) v David Jones Ltd* (1975) 2 NSW Listing Rules 710; *Corporate Affairs Commission (SA)* v *Australian Central Credit Union* (1985) 157 CL Rules 201; 1985 (61) AL Rules 236; 10 ACL Rules 59. In *HKSAR v Ma Wai-kwan and others* (29 July 1997), the Hong Kong Court of Appeal held that the Common Law and rules of equity of England which applied in Hong Kong on 30 June 1997 continue to apply in Hong Kong, subject to their independent development.

- Subsisting relationship between the offeror and offerees;[200]
- Characteristics of the group of offerees;[201] and
- Connection between the nature of the offer and the characteristics of the offerees.[202]

Under the Listing Rules, rule 8.24 provides that the SEHK will not regard any connected person of a listed company as a member of the public. Rule 8.24 states that, in addition, the Stock Exchange of Hong Kong will not recognise the following persons as members of the public:

- Any person whose acquisition of securities has been financed directly or indirectly by a connected person; or
- Any person who is accustomed to take instructions from a connected person in relation to the acquisition, disposal, voting or other disposition of securities of the issuer registered in his name or otherwise held by him.

Securities and Futures Commission Exemptions. Under sections 38A and 342A of the Companies Ordinance, the SFC is empowered to grant exemptions on application or by its own motion (either on a case-by-case basis or generally through subsidiary legislation) from compliance with certain prospectus-related requirements if it considers that compliance with the requirements would either be irrelevant or unduly burdensome.

Place of Order

In Hong Kong, as in many other jurisdictions with developed securities law, hawking of securities is generally prohibited. Section 174(1) of the SFO imposes a generally prohibition against hawking of securities:

> 'An intermediary, or a representative of an intermediary, may not, as principal or agent, during or as a consequence of an unsolicited call[203] made, whether in Hong Kong or elsewhere, by it or him –

200 Whether a subsisting relationship between the offeror and offerees renders an offer private will depend on the nature of the relationship, in particular, whether the relationship in question is commercial in nature. Section 48A provides that an offer made to clients is not necessarily a private offer. As the objective of the Companies Ordinance is to protect the investing public, the authorities are unlikely to interpret the provisions of the Ordinance liberally.

201 If an offer is made on terms that only certain persons are eligible to accept, it is more likely to be a non-public offer. *Corporate Affairs Commission (SA)* v *Australian Central Credit Union* (1985) 157 CL Rules 201, at p 209; 1985 (61) AL Rules 236 and 241; 10 ACL Rules 59 and 63.

202 A rational connection between the common characteristic of the offerees and the nature of the offer will point towards the existence of a private offer. The connection should be such that the offerees' interests in the subject matter of the offer are so special that it is not necessary to protect them as public investors.

‘(a) make or offer to make with another person -

‘(i) an agreement for that other person to sell or purchase, or with a view to having that other person sell or purchase, any securities, futures contract or leveraged foreign exchange contract;

‘(ii) an agreement to provide, or with a view to providing, to that other person securities margin financing; or

‘(iii) an agreement the purpose or effect, or pretended purpose or effect, of which is to provide, whether conditionally or unconditionally, to that other person a profit, income or other returns -

‘(A) from any securities, futures contract or leveraged foreign exchange contract; or

‘(B) calculated by reference to changes in the value of any securities, futures contract or leveraged foreign exchange contract; or

‘(a) induce or attempt to induce another person to enter into an agreement referred to in paragraph (a), whether or not in making the unsolicited call it or he does any other act or thing.’

Section 174(2) of the SFO provides that:

‘An intermediary, or a representative of an intermediary, may not be regarded as contravening subsection (1) by reason only that it or he -

‘(a) makes a call on another person who is a solicitor or certified public accountant acting in his professional capacity, or is a licensed person, registered institution, money lender or professional investor, or its or his existing client; and

‘(b) whether as principal or agent, makes or offers to make with that other person an agreement referred to in subsection (1)(a), or induces or attempts to induce that other person to enter into such an agreement.’

Section 174(3) of the SFO grants certain exceptions to the section 174(1) prohibition and provides that section 174(1) does not apply to:

‘(a) agreements relating to securities, futures contracts or leveraged foreign exchange contracts or to securities margin financing which are of

203 ‘Call’ is defined broadly in section 174(7) of the Securities and Futures Ordinance. However, section 3 of the Securities and Futures (Unsolicited Calls-Exclusion) Rules provides for various excluded unsolicited calls for the purpose of the Securities and Futures Ordinance.

a class prescribed by rules made under section 397 for the purposes of this paragraph;

'(b) calls made by a person who is of a class prescribed by rules made under section 397 for the purposes of this paragraph;

'(c) calls made on a person who is of a class prescribed by rules made under section 397 for the purposes of this paragraph;

'(d) calls which are of a class prescribed by rules made under section 397 for the purposes of this paragraph.'

Section 174(5) of the SFO provides that any person who contravenes section 174(1) is guilty of an offence and liable, on conviction, to a fine at level 5.[204]

Listed Securities

Where publicly offered securities are to be quoted on the SEHK, in addition to the requirements imposed by the Companies Ordinance (discussed above), the prospectus also must comply with the listing requirements. The listing requirements aim to provide all relevant information to potential investors by way of prescribed disclosure.

Appendix 6 of the Listing Rules (*Placing Guidelines for Equity Securities*) sets out the SEHK's placing guidelines for private placements of equity securities. These requirements assume a distribution of the relevant securities through members of the Stock Exchange of Hong Kong. If this is not the case, the issuer is required to obtain further waivers from the SEHK in respect of the Appendix 6 requirements.

A private placement will not normally be permitted unless the market capitalisation of the securities to be placed is at least HK $25 million,[205] which would normally require the company's market capitalisation to exceed HK $100 million.

Unlisted Securities

An offer of unlisted securities will need to comply with the requirements of the Companies Ordinance, unless otherwise exempted under the provisions discussed above.

Disclosure of Acquisition of Substantial Holdings

In General. Part XV of the SFO sets out certain disclosure requirements relating to substantial holdings of securities. It affects all companies listed on the SEHK,

204 This is a maximum of HK $50,000: section 113C and Schedule 8 of Criminal Procedure Ordinance (Cap 221).

205 Listing Rules, Appendix 6, para 1.

regardless of their place of incorporation. Generally, the companies are required to provide the investing public with information on details of shareholders and holdings of directors and chief executive officers.

It may be worth noting that the SFO only governs matters that take place after its commencement on 1 April 2003. Non-disclosure of interests which took place before 1 April 2003 are still governed by the repealed Securities (Disclosure of Interests) Ordinance. However, due to limited space, this chapter will not cover the Securities (Disclosure of Interests) Ordinance.

Applicability. The SFO, Part XV, applies to officers and substantial shareholders of all companies listed in Hong Kong. Breach of disclosure requirements under the SFO constitutes a criminal offence, and any person liable on conviction or indictment is subject to a fine and imprisonment for two years, or on summary conviction to a fine and imprisonment for six months.[206]

There has been some debate as to whether Hong Kong's laws should be expressed to have extra-territorial effect. In practical terms, however, Hong Kong criminal law can only be enforced within Hong Kong.

Shareholders' Duties. Part XV of the SFO imposes disclosure obligations when a person's shareholdings reach a particular threshold. A person is required to make a disclosure if:

- He had, at the commencement of the SFO,[207] or acquires after the commencement of the SFO, an interest of 5 per cent or more in the issued share capital of a listed company (a 'notifiable interest');[208] or
- He has a short position in the issued and unissued shares comprised in the share options of a listed company of one per cent or more.[209]

The time limit for disclosure is three business days after the day on which the shareholder becomes aware of the event giving rise to the duty of disclosure.[210] 'Relevant share capital' means issued share capital of a class of shares which carries voting rights in all circumstances at general meetings of the company, and unissued shares of a class of the listed company's share capital which, if issued, would carry voting rights in all circumstances at general meetings of the company.

206 Securities and Futures Ordinance, s 328. See also Securities and Futures Ordinance, s 351 in relation to company officers.

207 Part XV of the Securities and Futures Ordinance came into effect on 1 April 2003. The provisions were derived from section 3 of the repealed Securities (Disclosure of Interests) Ordinance (Cap 396).

208 Securities and Futures Ordinance, s 315(1)(a). This was reduced from 10 per cent under the repealed Securities (Disclosure of Interests) Ordinance (Cap 396), to bring Hong Kong in line with international standards.

209 Securities and Futures Ordinance, s 315(2)(a).

210 Securities and Futures Ordinance, s 325. 'Business day' generally includes Saturday. This was reduced from five working days under the repealed Securities (Disclosure of Interests) Ordinance (Cap 396).

'Interest in shares' comprised in relevant share capital includes interests in issued and unissued shares, as well as the underlying shares of equity derivatives that a person has, or ceases to have, by virtue of the holding, writing or issuing by him of equity derivatives, or the assignment by him or the lapse of rights under the equity derivatives.[211] 'Interest in shares' includes 'an interest of any kind whatsoever'.[212] Under the CCASS system, the HKSCC, which operates the CCASS system, is the legal owner of all securities in Hong Kong publicly listed companies that have entered the CCASS trading system. The securities are registered in the name of HKSCC or its nominees. Accordingly, a change of equitable interest (as opposed to the passing of legal title) also may trigger disclosable interests.

'Equity derivatives' means any right, options or interests in or in respect of the underlying shares, or contracts the purpose or pretended purpose of which is to secure or increase a profit or avoid or reduce a loss, wholly or partly by reference to the price or value, or a change in the price or value, of the underlying shares or any rights, options or interests referred to above.[213] 'Basket derivatives' are excluded, and refer to equity derivatives where no less than five listed companies' shares will be required to be delivered on the exercise of rights or fulfilment of obligations under the equity derivatives, and at the time of issue, no more than 30 per cent or such other prescribed percentage of value of all the shares which would have been the underlying shares of the equity derivatives is represented by the shares in any one of those listed companies, or where the prices or values of no less than five listed companies' shares play a part in the derivation or determination of the price or value of the equity derivatives and no more than 30 per cent or such other prescribed percentage of the price or value of the equity derivatives is derived from or determined by the prices or value of the equity derivatives or is derived from or determined by the prices or values of the shares in any one of those listed companies.

Hence, interests in non-voting shares remain not disclosable for the purposes of sections 310–313 of the SFO. However, interests in subscription warrants, put options, call options, convertibles and executive options will need to be disclosed. Under sections 308(1), 310 and 313 of the SFO, short positions may no longer be netted off with long positions and must therefore also be disclosed.

Small changes (of 0.5 per cent or less) in shareholdings do not need to be further disclosed by shareholders already holding five per cent or more of issued share capital of a listed company (commonly referred to as the '*de minimis*' exception).[214] If the percentage level of interests in shares or short position in

211 Securities and Futures Ordinance, ss 311(2), and 322(8), 322(12). The inclusion of equity derivatives means that the scope of interest in shares to be included is much wider than the disclosure requirements under the repealed Securities (Disclosure of Interests) Ordinance (Cap 396).

212 Securities and Futures Ordinance, s 322.

213 Securities and Futures Ordinance, s 308(1).

214 Securities and Futures Ordinance, s 313(7).

shares at a relevant time (after rounding down to the next whole figure) is the same as or less than the percentage level of last notification, and the difference between the two percentage figures (without round down) is less than 0.5 per cent, no disclosure duty arises.[215]

In practice, due to the complexity in applying the *de minimis* exception, many shareholders may disclose such small movements of shareholding even though this exception may be applied. In addition to the disclosure obligations of direct shareholding interests, sections 316 and 317 of the SFO require indirect interests to be disclosed. A person is deemed to be indirectly interested in the shares:

- In which his spouse or any child under the age of 18 years is interested;[216]
- Which are beneficially owned by a company (whether incorporated in or outside Hong Kong) in which that person exercises one-third or more of the voting power at general meetings;[217]
- Which that person has contracted to purchase;[218]
- In respect of which the person is not the registered holder but is entitled to exercise any right conferred by the holding of the shares or is entitled to control the exercise of any such right;[219]
- In respect of which that person has a right (whether conditional or absolute) to subscribe for shares or call for delivery of shares;[220]
- In respect of which that person has the right or is under an obligation (whether conditional or absolute) to take an interest;[221]
- In respect of which that person is a party to a 'section 317 agreement', ie, deemed to have an interest in the shares in which any other party to the section 317 agreement also has an interest (concert party interests);
- In respect of which that person is the holder, writer or issuer of equity derivatives, ie, deemed to have an interest in the underlying shares of the equity derivatives if he has a right to require another person to deliver those underlying shares to him, or he is under an obligation to take delivery of the underlying shares, or he has a right to receive from another person an amount if the price of the underlying shares increases, or he has a right to avoid or reduce a loss if the price of the underlying shares increases;[222] and

215 Securities and Futures Ordinance, ss 310 and 313.
216 Securities and Futures Ordinance, s 316(1).
217 Securities and Futures Ordinance, s 316(2). A person also would be caught by this provision if that company, or its directors, are accustomed to acting in accordance with that person's directions. There is a 'tracing' provision which provides for the tracing of such voting powers through the corporate structure on a one-third voting power basis.
218 Securities and Futures Ordinance, s 322(5)(a).
219 Securities and Futures Ordinance, s 322(5)(b).
220 Securities and Futures Ordinance, s 322(7)(a).
221 Securities and Futures Ordinance, s 322(7)(b).
222 Securities and Futures Ordinance, s 322(8).

- In respect of which that person having a joint interest or short position is deemed to have an interest in the shares.[223]

Section 317 of the SFO deals with concert party interests, and applies to an agreement between two or more persons, which includes provisions (a) for the acquisition of interests in shares in the 'relevant share capital' of a listed company, and (b) which impose obligations or restrictions regarding the use, retention or disposal of the shares which are the subject of the agreement, or provides for the making of a loan or the providing of security for a loan, by a controlling person or a director of the target company to any person on the understanding or with the knowledge that such loan would be used for the acquisition of an interest in shares compromised in the relevant share capital of the target company, and an interest in shares in the relevant share capital of the target company is in fact acquired by any of the parties in pursuance of such agreement.

Certain interests in shares exceeding the regular disclosure threshold are excluded from disclosure. Section 323 of the SFO contains the main exclusions:

- Interest of a bare trustee, interest in reversion or remainder, and any discretionary interest in respect of shares held on trust;
- Interest for the life of a person, or of another, under an irrevocable settlement and the settlor has no interest in any income arising under, or property comprised in, the settlement;
- Exempt custodian interest;
- Interest which subsists by virtue of an authorised collective investment scheme or registered provident fund scheme; and
- 'Exempt security interest', ie, interests in shares held by a person who is an authorised financial institution or an insurer authorised pursuant to the Insurance Companies Ordinance or a person licensed or registered for securities dealing, or security margin financing under the SFO.

Such shares are held by way of security only for the purposes of a transaction entered into in the ordinary course of business as such a qualified lender. The exemption will no longer be available when the qualified lender becomes entitled to exercise voting rights in respect of the shares held as security as a result of or following a default by the person giving the security interest, and has evidenced an intention to exercise the voting rights or control their exercise, or taken any step to exercise the voting rights or control their exercise, or when the qualified lender offers for sale the security interest when the power of sale becomes exercisable.

In normal circumstances, a charge over the shares in a listed company held by a bank in the ordinary course of its business will be an 'exempt security interest'. The bank as the beneficial owner of the shares will, assuming that the number of shares exceeds the five per cent threshold, be obliged to disclose its beneficial

223 Securities and Futures Ordinance, s 322(14).

interest. Directors and chief executives of a listed company have to disclose any trust interests in which they are the discretionary objects if the trust property consists of shares in the company in which they are directors or directors of its associated company.[224]

Directors' Duties. The duties of disclosure placed on directors, chief executives and shadow directors are more onerous than those placed on shareholders.[225] A duty to disclose may arise even though a shareholding is not 'substantial'. The main differences between the duties of company officers and substantial shareholders' obligations are described below:

- There is no percentage threshold applicable to disclosures by company officers. Any shareholding and short position, however small, must be disclosed;
- Officers' interests in the debentures of a listed company, as well as shares, and short position must be disclosed; and
- Disclosure of interests in shares, debentures and short position in shares of 'associated corporations' of the listed company also is required. An 'associated corporation' in relation to a listed company means a corporation (whether incorporated in Hong Kong or elsewhere) that is: (a) a holding company, subsidiary or fellow subsidiary of the listed company or (b) a company in which the listed company holds shares of a class exceeding in nominal value 20 per cent of the nominal value of the issued shares of that class.

Companies' Duties. Division 5 of Part XV of the SFO grants wide powers of investigation to listed companies to ascertain the persons who are or were, within the past three years, interested in its relevant share capital and the nature of such interests.

The wide powers of investigation may be invoked on the listed company's own volition.[226] At the same time, however, the listed company is obliged to carry out such an investigation if it receives a written requisition from shareholders holding at least 10 per cent of its paid-up voting capital for it to do so.[227]

The disclosure obligations imposed on any such interested person under section 329 of the SFO are far more extensive than the disclosure obligations of substantial shareholders in sections 310–323 of the SFO, in that:

- The exemptions contained in section 323 of the SFO (described above) are not applicable;
- There is no threshold below which disclosure need not be made; and

224 Securities and Futures Ordinance, s 345.
225 Securities and Futures Ordinance, Divisions 7–9.
226 Securities and Futures Ordinance, s 329.
227 Securities and Futures Ordinance, s 331.

- The disclosure requirement is extended to any person who has or previously had a right to subscribe for shares in a listed company which would on issue be comprised in the relevant share capital.

The exercise of these investigative powers gives rise to certain obligations on the part of the listed company. Any information received by the listed company pursuant to an investigation which it carries out under section 329 of the SFO must be entered into a separate part of its register of interests in shares and short positions and be directed to the SEHK, the SFC and (where appropriate) the Commissioner of Banking.[228]

Where a section 329 notice is issued on a requisition by shareholders, the company must prepare a final report (and, if the investigation is not concluded within three months, an interim report for each three-month period during the investigation) on the information received,[229] which must be made available at the company's registered office within 10 business days of the end of the period to which it relates. The company must notify the shareholders in question within three days that the report is available. The listed company also must publish the report at such time, in such manner and for such period as may be specified by the SFC by notice published in the Gazette. The report must be made available for inspection by any member of the company and the public.[230]

The company also is required to deliver a copy of the report to the SEHK, the SFC and, where appropriate, the HKMA before the end of the business day after the report is first made available at the company's registered office.[231]

Substantial Shareholders' Register. Every listed company must keep a register of substantial shareholders to record information received from a person in the performance of his disclosure obligation under Divisions 2-5 of the SFO, and to record cessation as to an interested party in an agreement to which section 317 of the SFO applies. The register of substantial shareholders must be updated within three business days after the day on which such information arises.[232]

Officers' Register. Every listed company also must keep an officers' register for the purpose of recording information given by an officer in the performance of a duty of disclosure under Division 7-9 of the SFO.[233] Thus, whenever a company receives information from any of its directors or its chief executive officer pursuant to section 352(5) of the SFO, it is under a duty to enter in the officers' register, against the officer's name, that information and the date of the entry within three business days after the day on which the relevant information was received.

228 Securities and Futures Ordinance, ss 337 and 330.
229 Securities and Futures Ordinance, s 332.
230 Securities and Futures Ordinance, s 22.
231 Securities and Futures Ordinance, s 333.
232 Securities and Futures Ordinance, s 336.
233 Securities and Futures Ordinance, s 352.

Both the substantial shareholders' register and the officers' register must be kept at the registered office of the company in Hong Kong or in the place where the company's register of members is kept. In the case of a foreign company, the registers must be kept at the company's principal place of business in Hong Kong. The foreign company must inform the Registrar of Companies of the place where the registers are kept and of any change in that place, unless such registers are kept at the company's registered office in Hong Kong.[234] Both registers must be made available for inspection by any member of the company (without charge) and by the public (with a maximum charge of HK $10) for at least two hours a day during normal business hours.

Authorised Financial Institutions. If a listed company or any of its subsidiaries is an authorised financial institution, namely a bank or a deposit-taking company licensed or registered under the Banking Ordinance, any notification given by the company to the SEHK also must be given to the Commissioner of Banking.[235]

Hong Kong Financial Secretary. The SFO empowers the Hong Kong Financial Secretary to investigate and report on the ownership of shares under certain circumstances under section 356 of the SFO.

The Financial Secretary may make a 'freezing order' in respect of shares registered in a Hong Kong Register of members or on equity derivatives in respect of Hong Kong registered shares in relation to which an offence has been committed.[236]

Market Misconduct, Insider Trading and Fraud

Basis of Territorial Link. Besides criminal and civil liabilities, insider dealing activity poses serious reputation risk. Banks, securities and futures licensees and listed companies are required to establish and maintain appropriate internal control systems, including measures to ensure compliance with all relevant laws and rules. For example:

- The SFO requires every company to put in place reasonable measures to prevent its officers from engaging in insider dealing.[237] Failure by any officer to comply with these measures may give rise to civil sanctions under section 258 of the SFO (including disqualification as a director and prohibition from dealing in securities for a period not exceeding five years).
- The Listing Rules impose a general obligation on listed companies to disclose price-sensitive information to the market in a timely manner.[238] In addition, directors of listed companies are restricted from dealing in securities of their

234 There is a prescribed form for this purpose.
235 Securities and Futures Ordinance, s 330.
236 Securities and Futures Ordinance, s 367.
237 Securities and Futures Ordinance, s 279.
238 Listing Rules 13.09.

company.[239] The directors of listed companies are also required to ensure that employees of the companies who are likely to be in possession of unpublished price-sensitive information are subject to the same dealing restriction.[240]

- Staff members of HKMA-regulated institutions are prohibited from dealing in the securities of any listed company when the institution is in possession of privileged or price-sensitive information not generally known to the public.[241]
- Persons licensed by or registered with the SFC are required to implement and maintain measures appropriate to ensure compliance with SFC and the SEHK rules, regulations and codes.[242]

The SFO utilises dual civil (Part XIII) and criminal (Part XIV) regimes to regulate market conduct. The SFC can either bring a civil case before the Market Misconduct Tribunal (MMT)[243] or commence criminal proceedings against an alleged insider dealer. In deciding whether to prosecute, the SFC will have regard to the guidelines in the prosecution policy of the Department of Justice, which require two basic factors to be considered:

- The strength of the SFC's case — The burden of proof is greater in criminal proceedings and the SFC will only recommend criminal proceedings where there is admissible and reliable evidence that an offence has been committed and there is a reasonable prospect of a conviction. Where there is insufficient evidence to meet the criminal burden of proof, the SFC is likely to initiate civil proceedings.
- Public interest — Whether it is in the public interest to bring a prosecution before the courts, taking into account the circumstances of a particular case.

Under the civil regime, the SFC is empowered to impose a financial penalty not exceeding the greater of HK $10 million or three times the amount of profit gained or loss avoided by the insider dealer.[244] Under the criminal regime, an insider dealer could be subject to a maximum fine of HK $10 million and 10 years' imprisonment upon conviction.[245] The first conviction leading to jail sentences for insider dealing took place in 2009. Ten individuals were convicted of insider dealing in the indictable trials for this offence under the SFO, including a former managing director of a global bank who was jailed for seven years and fined $23 million, a record high imposed on an insider.

239 Listing Rules, Appendix 10. See discussion in previous section 'Periodic Disclosure — Restrictions on Trading'.
240 Listing Rules, Appendix 10, para 13.
241 Code of Conduct module of the Supervisory Policy Manual issued by the HKMA.
242 Code of Conduct for Persons Licensed by or Registered with Securities and Futures Commission, para 12.1.
243 The MMT is modelled on the Insider Dealing Tribunal (IDT) under the old law (Securities (Insider Dealing) Ordinance, Cap 395), but with expanded jurisdiction to deal with all forms of market misconduct.
244 Securities and Futures Ordinance, s 194(2).
245 Securities and Futures Ordinance, s 303(1).

The first indictable prosecution for market manipulation under the SFO also happened during 2009. Separately, the SFC also maintained civil proceedings to secure the suspected proceeds of market misconduct. In one case the SFC secured interim orders freezing assets generated from a suspected fraud of up to HK $1.655 billion, the largest amount that the SFC had ever applied to the Court to freeze.

The Market Misconduct Tribunal (MMT), established in 2003, carries out civil proceedings and hears cases referred to it by the Financial Secretary following investigation by the SFC. In 2009, the MMT concluded three cases, and nine persons or companies were found to have engaged in market misconduct. The MMT's predecessor, the Insider Dealing Tribunal (IDT), finalised its last two cases, bringing the number of cases concluded by the IDT to 27 and finding 65 persons culpable of insider dealing.

The definition of insider dealing is the same under both civil and criminal regimes. It is defined in the SFO by reference to various situations in which insider dealing occurs.[246] It has been noted that the majority of successful convictions for insider dealing by the SFC fall under one of the following scenarios:[247]

- Where a person connected with a listed company deals in (or counsels or procures another to deal in) the securities of the listed company (or a related company) when the person is in possession of what he or she knows to be inside information (ie, price-sensitive information not available to the public-at-large);[248]
- Where a person receives inside information and then deals in (or counsels or procures another to deal in) the securities or derivatives to which the information relates; and
- Where a person connected with a listed company receives inside information and then discloses the information to another person knowing that the other person will make use of the information to deal in (or counsel or procure another to deal in) the securities or derivatives to which the information relates.

In *HKSAR v Ma Hon-yeung*,[249] a vice-president of a financial institution tipped off his girlfriend and family members about a proposed privatisation of a listed

246 Securities and Futures Ordinance, ss 270 and 291.

247 Chalk, R. et al, 'Insider dealing in Hong Kong: lessons learned from recent convictions', *Hong Kong Lawyer* (Feb 2010).

248 In April 2009, an accounting manager of a subsidiary of a listed company was fined and jailed for insider dealing in shares of another listed company after he misused price-sensitive information about a proposed asset swap transaction between the two listed companies. In February 2012, an independent non-executive director of the HK Aircraft Engineering Company Ltd (HAECO) was fined HK$ 50,000 and jailed for five months for purchasing HAECO shares after being informed by the CEO of HAECO that Cathay Pacific Airways Ltd, a substantial shareholder of HAECO, would sell all its HAECO shares to Swire Pacific Ltd (a deal which would trigger a general offer for all shares in HAECO).

249 [2009] HKCU 2134.

company. All of them bought shares in the listed company prior to the proposed deal and made a profit. The vice-president and his girlfriend were given custodial sentences and the family members were ordered to do community service.

Fines were also imposed in the amounts equal to profits made by the defendants. This case, in March 2009, was the first indictable trial in the District Court for insider dealing under the SFO. To avoid dual civil and criminal provisions creating an excessive burden, Parts XIII and XIV of the SFO contain 'anti-double jeopardy' provisions.[250]

SFC Investigations and Secrecy Provisions. These are set out in section 378 of the SFO, creating the secrecy obligation, the exceptions to it and the consequences of breaching it.

There is the legal requirement that, except in the performance of a function under the SFO or for the purpose of carrying into effect or doing anything authorised under any of the provisions of the SFO, a 'specified person' must not disclose any matter coming to his knowledge (including the fact that he is being investigated by the SFC; or the fact that he is in the course of assisting a person who is being investigated). The secrecy provisions disallow any person to have access to any record of information however compiled or stored or to communicate any document in his possession as a result of such investigation.

SFC Winding Up Powers. The SFC has the power to wind up companies if it believes this to be in the public interest.[251] Until recently, this power had never been exercised by the SFC before. On 26 July 2013, on evidence and allegations of fraud, the SFC initiated the high profile provisional liquidation of China Metal Recycling (Holdings) Limited, a Hong Kong-listed company (SEHK: 773). In its statement, the SFC said that it decided to take action to 'protect the interests of the company's shareholders, and creditors, and the investing public'.[252]

Public Takeover Bids

Territorial Application. Takeovers and mergers affecting public companies in Hong Kong are regulated by the SFC in accordance with the Code on Takeovers and Mergers (Takeovers Code). The Takeovers Code is administered by the Takeovers Executive in charge of takeovers and mergers in the Corporate Finance Division of the SFC in consultation with the Takeover and Mergers Panel. The Takeover and Mergers Panel (which consists of prominent members drawn from the financial and investment communities, as well as several directors of the SFC) hears matters referred to it by the SFC Takeovers Executive, reviews rulings made

250 Securities and Futures Ordinance, ss 283 and 307.
251 Securities and Futures Ordinance, s 212.
252 Available at SFC website (accessed 1 September 2013): http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=13PR69.

by the Executive and conducts disciplinary proceedings (which may be open to the public).

Traditionally, the Takeovers Code is a non-statutory code largely based on the London Code on Takeovers and Mergers. However, in recent years, there is a growing divergence of these two codes.[253] The Takeovers Code is not concerned with the financial or commercial advantages or disadvantages of a takeover or merger. Rather, its main objective is to achieve fair treatment[254] by requiring equality of treatment of shareholders, mandating disclosure of timely and adequate information to enable shareholders to make an informed decision as to the merits of an offer and ensuring that there is a fair and informed market in the shares of the public company which is the subject of a takeover or merger. The general principles of the Takeovers Code include:

- All shareholders must be given an opportunity to exit if control of a company changes;
- Offerors should only announce their offer after careful and responsible consideration;
- Parties to an offer must make full and prompt disclosure of all relevant information and avoid the creation of a false market;
- Rights of control should be exercised in good faith and there should be no oppression of minority shareholders; and
- Parties to the offer must cooperate with the Takeovers Executive and the Takeover and Mergers Panel.

The Takeovers Code applies to all public companies including those listed on the SEHK, whether they are incorporated in Hong Kong or overseas. Certain publicly listed vehicles, including unit trusts and mutual funds, appear to be exempt from the application of the Takeovers Code. With effect from 25 June 2010, the Takeovers Code also applies to SFC-authorised Real Estate Investment Trusts (REITs).

The great majority of Hong Kong listed companies are effectively controlled by one shareholder or a small group of shareholders acting in concert. A change of control can usually only be achieved when the controlling shareholder agrees to sell his shares or allow his shareholding to be substantially diluted through new share or convertible bond issues. Thus, the market for corporate control is effectively a private one, and there is generally no contest for control because either control has already changed through private agreement or the controlling shareholder has consolidated his control by acquiring shares held by the public.

Hence, the application of the Takeovers Code in Hong Kong is distinct from many other developed markets, even from the United Kingdom, where corporate control

253 For example, the London Code includes convertible securities in the calculation of trigger percentage and does not have the ‘creeper’ provision for shareholders holding between 30 per cent and 50 per cent of a listing company.

254 Takeovers Code, r 1.2.

is often spread quite widely across the investing public and the board of directors effectively exercise full control. In these markets, change of control will require the predator to make an offer to public shareholders for some or all of their shares, frequently leading to hostile takeover bids. Regulators in these jurisdictions would have to ensure the proper and orderly conduct of the bid, and that competition between interests remains fair.

As a result of the private nature of the Hong Kong market, the Takeovers Executive has taken an active role (compared with regulators in other countries) in investigating breaches of the Takeovers Code and in supervising the quality of disclosures in offer documentation. This is partly due to the comparative weakness in Hong Kong of other forms of market checks and balances (unlike other jurisdictions which require compliance documentation), as well as the generally higher cost of civil remedies.[255]

Connecting Factors — International Private Law

A typical contravention of the Takeovers Code involves the warehousing of shares by 'concert parties' for the purpose of avoiding the requirements of the Takeovers Code to make a mandatory general offer. Such cases normally also involve the making of false statements in public documents which, if evidence meeting the usual criminal standard is available, would lead to prosecutions under section 21 of the Theft Ordinance. For example, the Hong Kong District Court in September 2008 convicted two bankers, three corporate finance lawyers and a listed company financial controller of conspiracy to defraud in connection with their work on the takeover of imGO (later renamed 'Shanghai Land').

The Court found that they had played a part in connection with false and incorrect representations about the deal in various company documents (and, in some cases, concealment and non-disclosure of important materials) and in correspondence with the SEHK and SFC, and imposed jail sentences ranging from 12 to 33 months. While the Court of Final Appeal subsequently quashed the convictions of all five defendants, this case highlights the real risk corporate advisers face for material disclosure.[256]

However, as with most cases of offence relating to securities transactions, proving that a 'concert party' exists is extremely difficult.[257] The Takeovers and Mergers Panel generally based its decision on the existence of probative evidence, which is the standard for inquisitorial tribunals laid down by the Privy Council in the United Kingdom.

255 For example, the financial media in Hong Kong is less influential in encouraging the maintenance of proper standards.

256 *HKSAR v Habibullah* and others (FACC6/2010).

257 For examples of panel decisions regarding 'acting in concert', see: Merdeka Resources (http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/014g per cent20- per cent20Panel per cent20Decision-Merdeka per cent20(Final).pdf) and China Oriental (http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/panel_decision_20071206.pdf).

Following the principles applied by the London Panel on Takeovers and Mergers in its Decision of 5 May 1989 in relation to the Guinness Plc offer for The Distillers Company Plc., which was that Guinness be directed to make compensatory payments to the shareholders of United Distillers who were disadvantaged by the failure of Guinness to make a takeover offer at a time when Guinness breached the trigger provisions of the London Code, the Hong Kong Takeover and Mergers Panel also decided that the appropriate compensation should be the difference between the price at which the general offer should have been made and the price which the beneficial owner of the shares eventually received when he sold the shares.[258]

Procedural Requirements

The following highlight the basic features of the Takeovers Code and give a brief overview of its main procedural requirements. The terms and conditions of an offer for the shares of a public company are, to some extent, at the discretion of the offeror. However, the offeror must comply with the rules of the Takeovers Code, which aims to ensure that a considered and satisfactory offer is made to the shareholders affected by the offer. In prescribing the terms and condition of the offer, the Takeovers Code draws a distinction between a mandatory offer and a voluntary offer, and allows the offeror more flexibility in the latter case.

A mandatory offer must be made when a person (or two or more persons acting in concert) acquires 30 per cent or more of the voting rights of a company. A mandatory offer also is required if a person (or two or more persons acting in concert) holds between 30 per cent to 50 per cent of the voting rights of the company, and such person(s) acquires more than two per cent of the voting rights of the company over the preceding 12-month period. In either case, an offer must usually be made to the shareholders for the rest of the shares of the company. Other than acceptance condition, a mandatory offer must not be subject to other conditions. Hence, in the case of a mandatory offer in which the offeror and its concert parties already hold more than 50 per cent of the offeree, the offer is unconditional. For voluntary offers, in addition to the acceptance offer, the offer can be subject to other 'objective' conditions.

The Code imposes a general rule that all target shareholders be treated equally and hence should be offered the same price per share, such that no shareholder should receive additional or collateral consideration and in certain circumstances a 'best price' rule may apply. In the case of a mandatory offer, the 'best price' rule requires that the offeror pay no less than the highest price paid by the offeror for shares in the target company during the offer period and in the six-month period prior to the commencement of the offer.[259]

258 Takeovers and Mergers Panel Decision on Shun Ho Resources Holdings Limited ('Shun Ho'), (formerly Standard-Lloyds Limited), October 1993.

259 Takeovers Code, r 23.

'Acting in concert' is generally defined as any formal or informal agreement that involves active cooperation to obtain or consolidate control of 30 per cent or more of voting rights of a company by any of the persons acting in concert. This concept of parties acting in concert should not be confused with the definition of 'connected persons' under the Listing Rules.

The Takeovers Code contains extensive guidance on who is deemed or presumed to be acting in concert for these purposes. There are a number of specific rulings by the Takeovers and Mergers Panel on what specific scenarios the SFC regards as parties acting in concert which are beyond the scope of this chapter, details of which are available on the SFC website.

The overriding principle which governs the offer documentation is that an offeree's shareholders should be given sufficient information to enable them to make a properly informed decision on the offer. Information included in the offer document should be prepared to the same standard, and be verified in the same manner, as a prospectus for a public offer of shares.

General Principle 6 of the Takeovers Code provides for 'full and prompt disclosure of all relevant information and every precaution to avoid the creation or continuance of a false market'. Directors of the offeror and the offeree are required to accept full responsibility for the accuracy of the information set out in the documentation. Schedules I and II to the Takeovers Code set out the minimum contents requirement of the offer document.

The timing of despatch of the offer document to the shareholders of the offeree company is determined by reference to the announcement date. Generally, the offer document must be despatched within 21 days of the announcement in the case of a cash offer and 35 days in the case of a shares or securities exchange offer. Within 14 days of the posting of the offer document, a response document from the directors of the offeree company or their advisors must be sent out to its shareholders.

Consideration cheques must be posted to accepting shareholders within 10 days of the later of the date on which the offer becomes, or is declared, unconditional and the date of receipt of a duly completed acceptance.[260] If an offer is withdrawn or lapses, the offeror must return the lodged share certificates and acceptance form by post to the offeree company shareholders who accepted the offer.[261] Although the SEHK allows posting of electronic documents and circulars to shareholders on the website, the Takeovers Code requires posting of printed offer documents and acceptance forms.

One important aspect in a takeover is confirmation of financial resources to the SFC and disclosure in the offer document that the offeror has sufficient finance resources to satisfy the full acceptance of the offer; in the case where the offer is in

260 Takeovers Code, r 20.1.
261 Takeovers Code, r 20.2.

cash, or includes an element of cash, confirmation by a licensed financial adviser or by another appropriate independent party that resources are available to the offeror sufficient to satisfy full acceptance of the offer. The SFC Takeovers Executive often makes enquiries as to the details of such financial resources and often requests supporting evidence (commonly referred to as 'fund proof').[262]

The Takeovers Code contains rules on the conduct of the parties involved (for example, the target board is constrained in its ability to adopt defensive measures and frustrating actions),[263] all announcements made during the offer period, the revision or withdrawal of an offer, profit forecast, property valuation and dealing restrictions before and during the offer, and the requirements to establish an independent committee of the board and to retain a competent duly (licensed by the SFC to advise on Takeover Code issues) independent financial adviser to advise the independent committee in connection with the offer.[264]

It is important for the parties to consult the SFC Takeovers Executive on a proposed course of conduct to which the Takeovers Code may be applicable. In this way, the parties can clarify the basis on which they can properly proceed and thus minimise the risk of taking action which might potentially be a breach of the Takeovers Code or have adverse consequences to the offeror and its concert parties. Request for a ruling should be in the form of a written submission addressed to the Executive Director of the Corporate Finance Division of SFC, enclosing the applicable fees.

Exemptions

The Takeovers Code applies to all public companies in Hong Kong. To determine whether a company is a public company in Hong Kong, the following factors are likely to be relevant:

- The number of public shareholders in the company and the extent of trading in its shares in Hong Kong;
- The voluntary acceptance by the company of regulatory obligations, eg, through listing on the SEHK and adherence to listing obligations (which include compliance with the Takeovers Code);
- The location of the company's head office and place of central management;
- The location of the company's business and assets, including such factors as registration under companies legislation and tax status; and
- The existence or absence of protection available to Hong Kong shareholders as provided by any statute or code regulating takeovers, mergers and share repurchases outside Hong Kong.

262 Para 11 of Schedule I of the Takeovers Code.
263 Takeovers Code, r 4.
264 Takeovers Code, r 2.

Under certain circumstances, the SFC Takeovers Executive may consider waiving an obligation to make a general offer even when the company in question is a public company. These circumstances include where:

- A person incurs an obligation to make a general offer as a result of subscription of new shares in the public company and this person has not dealt in the existing shares in the past six months. This is commonly known as a 'whitewash waiver'.
- A shareholding in a company is pledged as security for a loan and, on foreclosure, the lender incurs an obligation to make a general offer.[265]
- A company is in such a serious financial position that the only way it can be saved is by the issue of new shares without a vote of approval by independent shareholders, or by the acquisition of existing shares by a rescue, which would normally require a general offer to be made. This is another form of 'whitewash waiver'.
- A person incurs an obligation to make a mandatory general offer as a result of an inadvertent mistake, provided that sufficient voting rights are disposed of to persons not connected with the potential offeror within a certain period of time.
- A person (or group of persons acting in concert) acquires 30 per cent or more of voting rights in that company but another shareholder, who must hold at least 50 per cent of the voting rights in that company, states that he will not accept the offer which the purchaser would otherwise be obliged to make.
- A shareholder places part of his existing holdings with independent persons and then subscribes for additional shares in the offeree company so as to reinstate his holding to the percentage held by him prior to the placement, at a price substantially equivalent to the placing price, after taking into account transactional expenses.

Recognition of Foreign Takeover Regulation

The Takeovers Code does not specifically recognise any foreign takeover or other regulations. An occasion in which the SFC had to consider whether it would recognise foreign takeover regulations resulted in the decision by Jardine Matheson Holdings, a multinational conglomerate which had strong historical links with Hong Kong, to withdraw its listing on the SEHK. The Jardine Matheson action followed a decision by the SFC not to agree to its proposal for an exemption or general waiver from the Takeovers Code.

Under one of the proposals put forward by Jardine Matheson, it was suggested that its companies should be exempted from the Takeovers Code because they were at

265 This exception will only be available if the shareholding was pledged to a bank or lending institution on an arm's length basis and in the ordinary course of business, and the lender did not foresee the foreclosure at the time of granting the loan. However, when a lender wishes to sell the shares after foreclosing, the mandatory offer provision will apply to the purchaser.

the time subjected to a regulatory takeover structure in Bermuda (where the group was legally domiciled). In 1993, the Bermuda authorities, at Jardine Matheson's request, enacted five statutory Takeovers Codes, one for each of the five companies in the Jardine Matheson group. This legislation was based on the non-statutory London Code, on which the Takeovers Code also is based. The five special Jardine Matheson Codes do not apply to other Bermuda-registered companies.

The SFC rejected Jardine Matheson's proposal because, in its opinion, the proposed regulatory structure requested by Jardine Matheson for itself in Bermuda did not provide adequate investor protection for Hong Kong shareholders. The administration of the five special Jardine Codes would involve regulation at a considerable distance which the SFC believed would not work to protect Hong Kong investors, especially when the relevant action was taking place in Hong Kong.

The SFC also thought that adequate regulation of takeover activity in Hong Kong required knowledge of the relationships between the parties in Hong Kong (to identify likely concert parties), knowledge of share trading patterns, share price movements and knowledge of other factors and circumstances unique to the Hong Kong business environment.

The Bermudan authorities understandably would not have the same knowledge of the market in Hong Kong as Hong Kong regulators. It would thus be very difficult for the Bermuda Monetary Authority to investigate alleged breaches of the five Jardine Codes taking place in Hong Kong. In addition, it was thought that it would be difficult and expensive for Hong Kong investors to protect their rights via the Bermuda authorities. It should be noted that, despite the withdrawal of its listing, Jardine Matheson remains a 'public' company in Hong Kong to which the Takeovers Code applies.

In effectively requiring Jardine Matheson to comply with two sets of takeover requirements, the SFC considered whether this would result in any serious obstacle to potential offerors wishing to take over any of the companies, and it concluded that, although potential offerors would have to abide by the stricter of the two sets of requirements, there did not appear to be any conflicting requirements. One further example in which the SFC Takeovers Executive recognises foreign regulation is their ability to relax the treatment of profit forecast under the Takeovers Code (which would otherwise require profit forecasts to be reported by both the offeree company's financial advisers and its accountants or auditors)[266] for a foreign offeree company, where such foreign offeree company can show that the requirement to disclose profit forecast or 'deemed' profit forecast would cause genuine practical difficulties.[267]

266 Takeovers Code, r 10.

267 See Practice Note 2: www.sfc.hk/sfc/doc/EN/cfd/mergers/practice_note/Practice per cent20Note per cent2002_EN_revised per cent20on per cent20280909.pdf.

Jurisdiction Differences

Genuine and False Conflicts

Under Hong Kong conflict of law rules, the applicable law governing the contractual aspects of a commercial contract is the governing law of the agreement. Accordingly, a Hong Kong court would recognise the validity of a security interest as between the contracting parties, if the security interest was validly created under the governing law of the security agreement (assuming the governing law was a valid and proper choice of law). However, the applicable law governing the proprietary aspects of a security interest granted under a security agreement over a share or debt security is the law of the place of its location (*lex situs*).[268]

Accordingly, *lex situs* governs the formalities and other perfection requirements which have to be satisfied in order to protect the security interest against competing claims from third parties. A Hong Kong court would recognise the validity of a security interest as regards third parties when the security interest is perfected pursuant to the *lex situs*. There is intense debate internationally as to where the location of certain types of assets is for the purposes of identifying the relevant *lex situs*.[269] The position under Hong Kong law for securities has been summarised as follows:[270]

- Directly held bearer securities — A directly held bearer security is located at the place where the bearer certificate is located;[271]
- Directly held registered securities — A directly held registered security is located at the place where the register is located;[272]
- Directly held dematerialised securities — A directly held dematerialised security is located at the place which establishes the statutory regime under which such dematerialised security is issued; and
- Indirectly held securities — The conflict of law rules relating to *lex situs* of indirectly held securities is complex. The general view in Hong Kong is that an indirectly held security is located at the place of the account or register of such security by the most immediate financial intermediary (regardless of where the interests in other tiers in the chain may be located).[273]

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268 *First Laser Limited v Fijian Enterprises (Holdings) Company and Another* [2008] HKCFI 87.

269 For example, see: M. Ooi, *Shares and Other Securities in the Conflict of Laws* (2003), Oxford University Press.

270 C. Liew et al, *Hong Kong Derivatives: Law and Practice* (2010), LexisNexis Butterworths, p. 168.

271 *Winans v AG (Number 2)* [1910] AC 27.

272 *Erie, Beach Co Ltd v AG for Ontario* [1930] AC 161.

273 C. Liew et al, 'Hong Kong Derivatives: Law and Practice' (2010), LexisNexis Butterworths, p. 168. This also was the solution adopted in the EU Directive on Settlement Finality in

Multilateral Approaches

Substantive Law Solutions

Harmonisation

With regard to the determination of *lex situs* of indirectly held securities, two international conventions try to address this situation, namely, the Hague Convention and UNIDROIT Convention. Neither has been ratified or adopted yet by Hong Kong.

The Hague Convention on the 'Law Applicable to Certain Rights in Respect of Securities Held by an Intermediary' was introduced on 5 July 2006. It aims to provide legal certainty and predictability as the law applicable to securities that are commonly held through clearing and settlement systems or intermediaries.

The Hague Convention seeks to establish a uniform method for the determination of *lex situs* of indirectly held securities and harmonise *lex situs* rules in different countries. It is worth noting that the Hague Convention rules are a modification to the 'place of relevant intermediary approach'. However, to date, Hong Kong has not ratified the Hague Convention and the Hague Convention does not have legal force in Hong Kong.

The UNIDROIT Convention on Substantive Rules regarding Intermediated Securities was adopted in Geneva, Switzerland on 9 October 2009. Unlike the Hague Convention, the UNIDROIT Convention aims to harmonise global rules regarding indirectly held securities by effecting a change in the substantive laws of signatory states (rather than through their conflict of law rules). Contracting states are permitted to opt out of certain rules in the UNIDROIT Convention. It remains to be seen whether, and to what extent, the UNIDROIT Convention is adopted by the PRC for Hong Kong.

Recognition

As capital flow becomes more global, strengthening co-operation amongst international regulators will enhance the supervision of cross-border securities trading activities. Instead of a proliferation of legislation to resolve jurisdictional differences, the policy of authorities in Hong Kong has been to enhance international co-operation with international and foreign securities organisations and regulators.

The SFC is a member of the International Organisation of Securities Commissions (IOSCO), which has worldwide regulatory authority members representing more than 85 per cent of the world's capital markets. Members of the IOSCO resolve to:

- Co-operate in developing, implementing and promoting adherence to internationally recognised and consistent standards of regulation, oversight and

Payment and Securities Settlement Systems 98/26/EC (see Ooi, *Shares and Other Securities in the Conflict of Laws* (2003), Oxford University Press, p. xxxi).

enforcement in order to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;

- Enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and
- Exchange information at both global and regional levels on their respective experiences in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.[274]

The SFC has entered into 86 co-operative arrangements with Mainland and overseas regulators for the purpose of exchange of information and/or investigatory assistance.[275] The SFC also provides and obtains investigatory assistance to/from overseas regulatory authorities from time to time, including obtaining affidavits, witness statements, non-public records and documents.

On 19 June 1993, the SFC and the SEHK entered into a Memorandum of Regulatory Co-operation (MORC) with the China Securities Regulatory Commission, Shanghai Securities Exchange and Shenzhen Stock Exchange. The MORC allowed PRC-incorporated entities to list their securities in Hong Kong, as well as assist the signatory parties to protect markets, and ensure compliance with each other's laws and rules through mutual assistance and exchange of information.[276]

In May 2002, IOSCO adopted the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation (MMoU). The SFC is a signatory to the MMoU. The objective of the MMoU is to enhance full investigatory co-operation among its signatories, and signatories are obliged to provide assistance to each other (including provision of information).[277]

Procedural Solutions

In *HKSAR v Ma Wai-kwan and Others* (29 July 1997), after considering the relevant provisions of the Basic Law and the Standing Committee's decision, the Hong Kong Court of Appeal held that the common law and rules of equity of England which applied in Hong Kong on 30 June 1997 continues to apply in the HKSAR, subject to their independent development.

Hence, as regards to all commercial matters (including conflict of laws), Hong Kong law will generally adopt the position in English law pre-30 June 1997.

274 See IOSCO website: www.iosco.org.

275 These include Australian Securities and Investments Commission, China Securities Regulatory Commission, and the Securities and Exchange Commission of the USA. Kwok and Amour, *Hong Kong Securities Law* (Dec 2009), Section I [205], LexisNexis.

276 Kwok and Amour, *Hong Kong Securities Law* (Dec 2009), s I [206], LexisNexis.

277 Kwok and Amour, *Hong Kong Securities Law* (Dec 2009), s I [206.1], LexisNexis.

English law authority after 1 July 1997 remains of persuasive value, although not binding. In all actions involving conflict of laws, questions of procedure (as opposed to substance) are always determined by the *lex fori* (ie, the law of the forum in which the case is being litigated). Procedural issues include questions as to the grant of remedies, questions as to who can sue and be sued as parties to the action, questions of evidence (save for presumptions) and the quantification of damages.

Unilateral Approaches

There is no territorial restriction on the scope of the SFO. Persons outside Hong Kong may be held to contravene the SFO. Hence, disclosure requirements under the SFO apply regardless of whether the holder of the interest or short position is resident, or has a presence, in Hong Kong. Similarly, any person (even if outside Hong Kong) who actively markets any services to the public in Hong Kong that would constitute a regulated activity would be subject to Hong Kong licensing requirements.[278]

A judgment of a foreign court would have no direct operation in Hong Kong. However, a foreign judgment may be enforceable in Hong Kong subject to certain conditions, either by action at Common Law or registration under statute. Compared to registration under statute, the Common Law process generally takes longer and costs more.

The normal method of enforcement by Common Law action does not apply for certain countries that have reciprocal arrangements with Hong Kong, whereby judgments in superior courts of Hong Kong will be recognised and enforceable in those jurisdictions and vice versa. Parties may not commence a Common Law action in respect of judgments from the courts of those countries. Judgments from the courts of those jurisdictions are enforceable by registering the judgment in accordance with any of the following statutes:

- Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319);[279]
- Judgments (Facilities for Enforcement) Ordinance (Cap 9);[280] or
- Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597).[281]

In each case, enforcement will be subject to the fulfilment of the requirements set out in the relevant Ordinance and the requirements of the Foreign Judgments (Restriction on Recognition and Enforcement) Ordinance (Cap 46).

278 Securities and Futures Ordinance, s 115.

279 This applies to judgments of commonwealth countries (ie, Bermuda, Brunei, India, Malaysia, New Zealand, Singapore, Sri Lanka and certain Australian courts), and other countries (ie, Austria, Belgium, France, Germany, Israel, Italy, and Netherlands).

280 This applies to judgments from English courts.

281 This applies to judgments in civil and commercial matters from certain designated PRC courts.

A foreign judgment that is not covered by the more direct process of registration under statute (discussed above) would still be enforceable in Hong Kong, subject to certain conditions, by action at Common Law. At Common Law, a foreign judgment from a foreign court of competent jurisdiction is enforceable if the following conditions are satisfied:

- The judgment is *in personam*;[282]
- The judgment is in the nature of a monetary award; and
- The foreign judgment is final and conclusive in the court in which it was rendered.

A foreign judgment will not be registered if:

- The foreign judgment is contrary to Hong Kong public policy;
- The foreign judgment is based upon a foreign penal or revenue law;
- The foreign judgment is tainted by fraud;
- The foreign judgment is contrary to natural justice (due process);
- The Hong Kong court had already given its own judgment in respect of the same matter; and
- The courts of the foreign country did not have jurisdiction to give that judgment under Hong Kong law.

The procedure of enforcing a foreign judgment under Common Law requires an action by way of writ in Hong Kong courts. The burden of proof lies with the person seeking to enforce a foreign judgment. As an alternative to litigation, Hong Kong also is among the 120 signatory jurisdictions to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Arbitration awards made in Hong Kong are enforceable in more than 120 jurisdictions which are signatories to this Convention, and vice versa.

282 I.e., the judgment is given against a person, as opposed to a judgment that is merely declaratory or *in rem*. *Emmanual v Symon* [1908] 1 KB 302.

India

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India

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Introduction

Regulatory System

The existence of an efficient and smooth functioning capital markets plays an important role in the economic development of a country.[1] It is widely believed that one of the key elements of a robust corporate governance regime in any country is the existence of a well-administered securities market. The organized securities market in India is almost 150 years old.

In 1877, the native stock and share brokers association (the 'Bombay stock exchange') was founded to protect and further the interests of the brokers and safeguard public dealing in securities by suppressing malpractices. Prior to World War II, India had three stock exchanges (Bombay, Calcutta, and Ahmadabad) and approximately 11, 372 joint-stock companies.

However, the watershed moment in India's securities regulation came in 1991–1992 when the liberalization of the Indian economy resulted in major reforms in the capital markets.[2]

The immediate effect of the liberalization was the diminishing role of the government as a direct player in the financial market. This necessitated setting up of procedures and guidelines for the creation and preservation of fair and

1 The views expressed in this chapter are the personal views of the authors. This chapter intends to provide an overview of the Indian securities regulations with special emphasis on the aspects that may be relevant to foreign participants. The authors have primarily relied on legislations, regulations, rules, judicial precedents, and committee reports on or before 10 August 2012 for the purposes of this chapter. At the time of writing, the Securities and Exchange Board of India, in its board meeting of 16 August 2012, resolved to make certain changes with respect to primary markets and regulation for investment advisors, and these have not been considered here as they have not been enacted into law.

2 P J Thomas Report, *Regulation of the Stock Market in India*, 1948.

transparent financial markets. Since then, India has seen a steady evolution of capital market regulation.[3]

While the initial threads of securities regulation were incorporated in the late 1980s through the listing agreement between the listed companies and the stock exchanges, a sophisticated legal framework was established only in 1992 under the Securities and Exchange Board of India Act, 1992 (the 'SEBI Act'). The SEBI Act accomplished two important goals.

It established a free and independent regulator, the Securities and Exchange Board of India (the SEBI) to monitor and govern the capital markets in India, and it provided the basic framework for investor protection and market regulation that was hitherto absent.

After 20 years of reforms in the financial sector, India has created a fairly sound regulatory framework for the important but vulnerable financial sector. There has been a convergence towards global best practices especially in securities regulation. While India has taken significant steps towards creating a robust capital market, the challenges, such as regulating new forms of financial products and financial inclusion as one would expect for a country of India's demography and diversity, remain persistent.[4]

Legal Sources

India has a written constitution wherein the power to enact laws vests solely with the central and state legislatures. However, as is the case with legislatures of most modern states, the Indian Parliament has delegated some of its law-making powers to independent regulators. In relation to the securities market, the Parliament has enacted five laws that provide the basic framework for capital markets regulation. These are:

- The Companies Act, 1956, which sets out detailed provisions relating to organization and functioning of various kinds of companies;
- The Securities Contract (Regulation) Act, 1956, which provides for regulation of stock exchanges and confers on stock exchanges the power to make rules and bye-laws governing transactions in securities;[5]
- The Securities Exchange Board of India Act, 1992, which establishes an independent board (the SEBI) to regulate and monitor the securities market, as well as protect the interest of the investors;

3 Report of the Joint Parliamentary Committee, *Stock Market Scam and Matters Related Thereto*, 13th Lok Sabha, December 2002.

4 Report of the Committee on Financial Sector Reforms, *A Hundred Small Steps*, (2009).

5 Most of the powers under the Securities Contract (Regulation) Act are exercised by the Department of Economic Affairs, government of India. Some of the powers exercisable under the Securities Contract (Regulation) Act are concurrently exercised by the Department of Economic Affairs and the Securities and Exchange Board of India.

- The Depositories Act, 1996, which provides for electronic maintenance and transfer of ownership of dematerialised securities;[6] and
- The Foreign Exchange Management Act, 1999, which regulates the inflow and outflow of foreign exchange to and from India, respectively, by providing a broad framework for permissible capital and current account transactions and any other dealings related to foreign exchange.

The SEBI also has laid down regulations in order to operationalize the mandate set out in the legislations. Some of the significant regulations that are relevant to capital market transactions are:

- The SEBI (Prohibition of Insider Trading) Regulations, 1992 (the 'Insider Trading Regulations'), are the principal regulations for monitoring and prohibiting insider trading in India;
- The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (the 'ICDR Regulations'), are the principal regulations governing the primary market, applying to all public issues, private placements, and issue of Indian depository receipts; and
- The SEBI (Substantial Acquisition and Takeovers) Regulation, 2011 (the 'Takeover Code'), regulates substantial acquisition of shares, voting rights, or control, and lays down the open offer and disclosure requirements in respect of such acquisition.

In addition, the equity listing agreement (the 'Listing Agreement') between the company (that is listed or is to be listed) and the stock exchange incorporates the terms and conditions of listing of securities. With respect to foreign participation in the capital markets, the important regulations under the regulatory domain of the SEBI are:

- The SEBI (Foreign Institutional Investors) Regulations, 1995 (the 'Foreign Institutional Investment Regulations'), which prescribe registration requirements and investment conditions for foreign institutional investors; and
- The SEBI (Foreign Venture Capital Investors) Regulations, 2000 (the 'foreign venture capital investor Regulations'), which prescribe registration requirements and investment conditions for foreign venture capital funds.

Authorities

Securities and Exchange Board of India

In General. The SEBI is the apex regulator of the securities market in India. The SEBI has a statutory mandate to regulate the securities market, protect the interest of the investors, and promote and develop the securities market. The SEBI seeks to fulfil this mandate by:

6 The Securities and Exchange Board of India administers the rules and regulation under the Depositories Act.

- Regulating business in the stock exchange or any other securities market;
- Registering and regulating the working of intermediaries, such as stock brokers, sub brokers, share transfer agents, bankers to an issue, trustee of trust deeds, merchant bankers, underwriters, and such other intermediaries who may be associated with the securities market;
- Registering and regulating the working of the depositories, depository participant, custodian of securities, foreign institutional investors and credit rating agencies;
- Promoting and regulating groups or associations of intermediaries;
- Promoting investor education and training of intermediaries; and
- Regulating substantial acquisition of shares and takeovers of listed companies.[7]

In order to achieve this statutory mandate, the SEBI is armed with a variety of quasi-legislative, quasi-executive, and quasi-judicial powers.

Delegated Legislation. The SEBI has the power to make regulations and rules and issue circulars. Typically, the regulations lay down the broad framework and circulars are only issued to clarify the existing regulatory framework.[8]

Inspection and Inquiry. The SEBI's power in relation to inspection and inquiry are akin to that of the civil court. The SEBI can order the discovery and production of books of accounts, summon the attendance of any person, and inspect the books and registers of any person.

These powers are triggered when the SEBI has reasonable grounds to believe that the transactions in securities are being dealt in a manner detrimental to the investors and the securities market or any intermediaries or persons associated with the securities market have violated any securities law, rules, or regulations.[9]

Power of Search and Seizure. The SEBI is empowered to apply to a competent court for an order for the search and seizure of books, registers, and places where such books may be kept, when it has reasonable apprehension that the records could be destroyed, altered, or mutilated.[10]

Interim and Post Inquiry Powers. During the pendency of the investigations or inquiry or after the completion of the investigations, the SEBI has the power to suspend the trading of any security in any recognized stock exchange, prohibit or restrain any person from dealing in securities, suspend any office bearer of a stock exchange, impound and retain the proceeds of securities in respect of any

7 Securities and Exchange Board of India Act, 1992, s 11; see http://www.igidr.ac.in/pdf/publication/WP-2011-008.pdf.
8 Securities and Exchange Board of India Act, 1992, s 11A.
9 Securities and Exchange Board of India Act, 1992, s 11C.
10 Securities and Exchange Board of India Act, 1992, s 11C.

transaction which is under investigation, and attach one or more bank accounts for a maximum period of one month with the approval of the competent court.[11]

Adjudication and Penalty. The SEBI is empowered to appoint adjudicating officers to adjudicate any matter and impose civil penalties. While exercising its adjudicatory powers, the SEBI can summon and enforce the attendance of any person.

Reserve Bank of India

The Reserve Bank of India does not play a direct regulatory role in the Indian capital markets. However, by virtue of being the apex banking authority and the primary regulator of transactions involving foreign exchange, the Reserve Bank of India plays a lead role in transactions involving foreign participation in the Indian capital markets.

Under the Foreign Exchange Management Act, the Reserve Bank of India is empowered to regulate and implement all foreign investments in India. The Reserve Bank of India is vested with powers of delegated legislation in respect of current account transactions, capital account transactions (including external or foreign debt), and the limits up to which foreign exchange will be admissible for such transactions. Additionally, the Reserve Bank of India may formulate regulations specifying the manner of, and limits to, retention or repatriation of foreign exchange.[12]

The Reserve Bank of India, together with the SEBI, the Insurance Regulatory and Development Authority and the Ministry of Finance, constitute the High-Level Group on Capital Markets. The primary role of the High-Level Group on Capital Markets is to coordinate domestic regulators in order to avoid regulatory overlap. The High-Level Group on Capital Markets has set up two standing committees, one for regulatory coordination and the other for coordination relating to the development of the debt market.[13]

Procedures

In exercising its powers, the SEBI is required to strictly adhere to the principles to the fairness and natural justice in any quasi-judicial proceeding. Typically, in any quasi-judicial proceeding, the SEBI appoints an adjudicating officer who issues a show cause notice to the concerned party. After the SEBI has reviewed the oral or written submissions of the concerned party, the SEBI passes a final order in respect of the proceeding.[14]

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11 Securities and Exchange Board of India Act, 1992, s 11(4).

12 Foreign Exchange Management Act, s 6.

13 Report of the Joint Parliamentary Committee, *Stock Market Scam and Matters Related Thereto*, 13th Lok Sabha, December 2002.

14 Securities and Exchange Board of India Act, 1992, s 12 and ch VIA.

An appeal against any order of the SEBI lies before the Securities Appellate Tribunal. The Securities Appellate Tribunal is not bound by the procedure generally followed in courts, but is guided by the principles of natural justice and fair play. The Securities Appellate Tribunal is empowered with all the powers which a court would normally have with respect to the summoning and enforcing the attendance of witness, adducing evidence, and reviewing its decisions.[15] To ensure the independence of the Securities Appellate Tribunal, the SEBI Act provides that the presiding officer of the Securities Appellate Tribunal can only be removed from office on the ground of proved misbehaviour or incapacity after an inquiry made by a judge of the Supreme Court of India.[16]

The decisions of the Securities Appellate Tribunal can be further appealed before the Supreme Court of India. The Supreme Court of India is a constitutional court and is the apex court of India. The Supreme Court of India has the power to declare any legislative or executive action unconstitutional. It also has the power to reverse or set aside an order of a judicial or quasi-judicial body.[17]

The SEBI, from time to time, issues an interpretive letter ('Informal Guidance') to resolve ambiguities in any Act, rules, or regulations relating to the securities market**.** Unlike circulars and guidelines which are issued by the SEBI *suo moto* to clarify a general legal issue, an informal guidance is issued when any market participant, such as an intermediary, a listed or any prospective acquirer under the Takeover Code, makes an application before the SEBI seeking a clarification in relation to a particular transaction.[18]

A market participant against whom any proceeding is likely to be instituted or is instituted may approach the SEBI for a settlement. Typically, a market participant is required to propose a settlement, which is then examined by a high-powered committee and, after considering the recommendations of the committee, the SEBI passes an appropriate consent order with respect to a settlement.

A consent order can be passed in respect of all types of enforcement or civil remedial actions, such as suspension or cancellation of registration, imposition of monetary penalty, pursuing suits, and appeals in courts and before the Securities Appellate Tribunal.[19]

15 Securities and Exchange Board of India Act, 1992, s 15T and U.
16 Securities and Exchange Board of India Act, 1992, s 15Q.
17 Securities and Exchange Board of India Act, 1992, s 15Z.
18 Securities and Exchange Board of India (Informal Guidance) Scheme 2003.
19 Securities and Exchange Board of India Act, 1992, s 15T(2).

Securities Market: Legal and Regulatory Order

Market Infrastructure Institutions

Stock Exchanges

The stock exchanges were established as associations of stockbrokers and this structure continued even post liberalization. However, in 2005, there was a paradigm shift in the regulatory framework and stock exchanges that were informal associations of stock brokers had to be corporatized. This was done by segregating the ownership and management of the stock exchanges from the trading rights of the members.[20]

With this intent in mind, the ownership requirements for the stock exchanges were notified by the government of the application of the SCR (Manner of Increasing and Maintaining Public Shareholding in Recognized Stock Exchanges) Regulations, 2006 (the 'MIMPS').

Presently, the individual limit for an individual (resident or non-resident) and financial institutions is capped at five per cent and 15 per cent, respectively. Furthermore, the members of stock exchanges who are involved in trading activities are allowed to cumulatively hold 49 per cent.[21]

Clearing Corporation

Clearing corporations perform a pivotal role in orderly settlement of trades in securities or other products that are dealt with or traded on a recognised stock exchange. A clearing corporation is only eligible to conduct business if at least 51 per cent of its shareholding is held by recognized stock exchanges.

The rationale for such a minimum limit was elaborated upon by a SEBI-appointed committee which believed that, since clearing corporations were at the core of the clearing and settlement function of the exchange, it would only favour the marketplace if the stock exchanges act as anchor investors to the clearing corporations.[22]

Depository/Depository Participant

Unlike some central securities depositories elsewhere that undertake both settlement and electronic record keeping of securities, in India, depositories only perform a record keeping activity. They are not directly connected with stock

20 Securities Contract (Regulation) Act, s 4A.

21 Consolidated Foreign Direct Investment Policy, Circular Number 1 of 2012, clause 6.2.22.

22 Report of the Committee on Review of Ownership and Governance of Market Infrastructure Institutions, November 2010 (the 'Bimal Jalan Report').

exchanges. The SEBI often uses records of depositories for its surveillance functions, independent of the data collected from stock exchanges.[23]

Foreign Investment in Market Infrastructure Institutions

The combined holding of all persons resident outside India in the equity share capital of a market infrastructure institution is capped at 49 per cent, subject to the following:

- The maximum permissible limit under foreign direct investment is capped at 26 per cent. Furthermore, the investment does not fall under the automatic route;[24]
- The maximum permissible limit for foreign institutional investors is capped at 23 per cent;[25] and
- Like resident individuals, individuals resident outside India also cannot invest more than five per cent of the equity share capital of a market infrastructure institution.

Primary Market

Public Issue

In General. Indian companies are allowed to raise capital through public issues in accordance with the ICDR Regulations. Public issues in India can be classified into two categories: an initial public offering or a follow-on public offering.

An initial public offering may either be an issue of fresh securities by an Indian company, or transfer of existing securities by existing shareholders of the company to the public, or a combination of both by an unlisted company to the public for the first time.

A follow-on public offering is a subsequent issuance of securities to the public or an offer for sale of existing securities to the public, by a listed company.

Eligibility Requirements. An unlisted company is permitted to make an initial public offering of its equity shares or any convertible securities[26] only if it satisfies certain requirements set out in the ICDR Regulations, such as:

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23 Depositories Act, s 18; see http://www.nseindia.com/content/us/ismr_full2011.pdf.

24 An approval from the Foreign Investment Promotion Board would be required prior to making the investment.

25 In the case of exchanges that are not listed, foreign institutional investors can only purchase the shares of the exchange through off market transactions and not through initial allotment, such as an initial public offering or a follow-on public offer. In the case of listed exchanges, foreign institutional investors are permitted to acquire shares only through transactions on the stock exchange and are not allowed to have their representatives on the board of a market infrastructure institution. MIMPS, reg 8(2)(d); Report of the Committee on Review of Ownership and governance of Market Infrastructure Institutions, November 2010 (the 'Bimal Jalaw Report').

- It has net tangible assets of at least INR 30 million in each of the three preceding years, of which not more than 50 per cent is held in monetary assets;
- It has distributable profits for at least three out of the immediately preceding five years;
- It has a net worth of at least INR 10 million in each of the three preceding years; and
- The proposed issue size and all previous issues in the same financial year does not exceed five times its pre-issue net worth as per the audited balance sheet of the last financial year.[27]

Issuer companies that do not meet the above mentioned (and other) basic eligibility norms still might be eligible to conduct an initial public offering or follow-on public offering under certain conditions.[28]

The proposed issue is made through the book building process, and the issuer company undertakes to allot at least 50 per cent of the net offer to the public[29] to institutional buyers such as mutual funds, venture capital funds, foreign institutional investors, scheduled commercial banks, or other qualified institutional buyers,[30] failing which the subscription monies must be refunded in full to the qualified institutional buyers, or at least 15 per cent of the project cost is contributed by financial institutions/scheduled commercial banks, of which not less than 10 per cent is contributed by appraisers.

The minimum post-issue face value capital of the issuer company is INR 100 million or the issuer company undertakes to provide market-making for at least two years from the date of listing of securities subject to fulfillment of certain conditions as specified in the ICDR Regulations.

Promoter Contribution. The promoters of the company proposing to list its securities are required to hold not less than 20 per cent of the post-initial public offering share capital of an issuer company.

In the case of a follow-on public offering, the promoters are required to hold either to the extent of 20 per cent of the proposed issue size or to the extent of 20

26 Regulation 2 of the ICDR Regulations defines a 'convertible security' as 'a security that is convertible into or exchangeable with equity shares of the issue at a later date, with or without the option of the holder of the security, and includes convertible debt instrument and convertible preference shares'.

27 ICDR Regulations, reg 26(1).

28 ICDR Regulations, reg 26(2).

29 ICDR Regulations, reg 2(u), defines 'net offer to public' as an offer of specified securities to the public but does not include reservations.

30 ICDR Regulations, reg 2(zd), provides that 'qualified institutional buyer' means a mutual fund, venture capital fund, foreign venture capital investor, foreign institutional investor or sub-account, a public financial institution, a scheduled commercial bank, bilateral development institution, a state industrial development corporation, provident fund, pension, fund, or insurance fund.

per cent of the post-issue capital. In computing the promoter's holding (or the minimum promoters' contribution as it is generally referred to), certain securities are not taken into consideration, such as securities acquired (in the preceding three years) for consideration other than cash or bonus shares arising out of revaluation of reserves.[31]

The minimum promoters' contribution would not apply to a follow-on public offering where the equity shares of the issuer are not infrequently traded on a recognized stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least the immediately preceding three years.

Lock-in Restrictions. 'Lock-in' means a freeze or restriction on the transferability of the securities and is analogous to a 'lock-up' as understood in the United States. The lock-in restrictions imposed on a company's share under the ICDR regulations are discussed below:

Lock-in Applicable to Securities Held by Promoters. The rationale for prescribing a lock-in restriction on the securities held by the promoters is to provide a safety net to investors by ensuring that the promoters retain some interest in the issuer company after the initial public offering.

Under the ICDR Regulations, the minimum promoters' contribution referred to above is locked in for three years from the date of commencement of commercial production or date of allotment of the securities in the initial public offering, whichever is later. The lock-in period for the shares held by the promoter(s) in excess of the minimum promoters' contribution is one year.[32]

Lock-in Applicable to Securities Held by Persons Other Than Promoters. In addition to the promoters' lock-in specified above, the entire pre-issue capital of the issuer company (other than the securities locked-in as minimum promoters' contribution) is locked-in for a period of one year from the date of allotment. However, the pre-issue lock-in requirement is not applicable to pre-issue shares held by a SEBI-registered venture capital funds or a SEBI-registered foreign venture capital investor.

This benefit is only available if shares have been held by the venture capital funds or registered foreign venture capital investor for at least one year as on the date of filing of the draft prospectus with the SEBI.[33] Equity shares held by employees under the employee stock option/purchase scheme of the issuer company before the initial public offering.[34] The exemption from the lock-in requirement is not available to employees who cease to be in the employment of

31 ICDR Regulations, reg 32.
32 ICDR Regulations, reg 36.
33 ICDR Regulations, reg 36(b).
34 ICDR Regulations, reg 37(a).

the company as on the date of allotment of shares pursuant to the initial public offering.[35]

Pricing. The issuer company may freely price the securities in consultation with the lead merchant bankers. The company also can offer securities at different prices subject to certain limitations.[36] Most companies opt for the book-building process to determine the price of the securities in an initial public offering.

The book-building process is used to determine the demand for the proposed issue of the securities. The price of the proposed securities is assessed taking into account the bids received. Where the issuer company opts for the book-building price discovery mechanism, underwriting becomes mandatory to the extent of the net offer to the public.[37]

Offer Document and Disclosure. The issuer company is required to file a draft red herring prospectus with the SEBI and the stock exchanges (where the securities are proposed to be listed) prior to filing the prospectus with the Registrar of Companies.

The SEBI and the stock exchanges may specify changes/observations to the draft red herring prospectus. At this stage, in-principle approval from the concerned stock exchanges must also be obtained. Thereafter, the issuer company must carry out changes as per the observations of the SEBI/stock exchanges before filing the prospectus with the Registrar of Companies.[38]

Prospectus Requirements. The promoter group is required to disclose in the offer documents the risk factors (internal and external), capital structure of the issuer company, objects of the offering, terms of the issue, interest of the directors, financial information of the issuer company, charter documents of the company, business of the issuer company, regulatory approvals, outstanding litigations, the issue procedure, and material contracts.[39]

Rights Issue

A listed company also can raise capital by issuing equity shares or convertible securities to its existing shareholders. This route is best suited for companies that intend to raise capital without diluting the stake of their existing shareholders.

35 Informal Guidance Multi Commodity Exchange of India Limited, CFD/DIL II/SK/RA/AEA/IG/OW/172 46/2012, 3 August 2012.
36 ICDR Regulations, reg 29.
37 ICDR Regulations, reg 13(2).
38 Companies Act, s 55A.
39 Companies Act, s 56, Schedule II, Part I, II, and III.

Private Placement

In General. A listed company can raise capital by issuing securities to any select group of persons on a private placement basis. Private placement can be either through preferential issue or qualified institutions placement.

Preferential Issue. A preferential issue by a listed company requires, *inter alia,* the shareholders of the company to pass a special resolution and the company to be in compliance with the Listing Agreement.[40] An issuer company is not permitted to make a preferential issue to any person who has sold any equity shares of the issuer during the six months preceding the date of issue.

If the shares of the company are listed for 26 weeks or more, the minimum price for a preferntial issue is the higher of the average of the weekly high and low of the closing prices of the related equity shares quoted on the stock exchange during the 26 weeks preceding the relevant date and the average of the weekly high and low of the closing prices of the related equity shares quoted on the stock exchange during the two weeks preceding the relevant date.[41]

The securities allotted on preferential basis to the promoter or promoter group are locked in for a period of three years from the date of allotment of the securities. This lock-in requirement is only applicable to 20 per cent of the total capital of the issuer. If the securities are allotted to any person other than a promoter or the promoter group on a preferential basis, the lock-in would be for a period of one year from the date of allotment.[42]

Qualified Institutions Placement. A listed company can further raise capital by issuing equity shares, non-convertible debt instruments with warrants and convertible securities other than warrants, mutual funds, venture capital funds, registered foreign venture capital investors, foreign institutional investors and sub accounts (other than a sub account which is a foreign corporate or foreign individual), scheduled commercial banks, pension funds, and other such qualified institutional buyers on a private placement basis.[43] Such an issuance is a qualified institutions placement.

Shareholders of a listed company must pass a special resolution approving the allotment of securities of the company through a qualified institutions placement. Equity shares of the same class that are proposed to be allotted through qualified institutions placement should be listed on a recognised stock

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40 As per section 189 of the Companies Act, a special resolution requires the positive vote of at least 75 per cent of the shareholders present and voting at a meeting of the shareholders.

41 ICDR Regulations, reg 76; Under the ICDR Regulations, 'relevant date' is the date that is 30 days prior to the date on which the meeting of the shareholders is held to consider the preferential issue. In the case of convertible securities, the relevant date is either same as aforesaid or a date 30 days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

42 ICDR Regulations, reg 78.

43 ICDR Regulations, reg 81(a) and (b), read with reg 2(1)(zd).

exchange for a period of at least one year prior to the date of issuance of notice to the shareholders for convening the meeting to pass the special resolution.

A placement document must be furnished to the stock exchange along with a certificate confirming compliance with the relevant provisions of the ICDR Regulations.[44] The qualified institutions placement route is subject to certain restrictions and limitations, as opposed to a preferential allotment.

Under this route there must be a minimum of two allottees and, in case the issue size is more than INR 2,500 million, the minimum number of allottees is required to be five. In addition, the promoter or promoter group cannot participate under this route even if they qualify as qualified institutional buyers. The qualified institutions placement route would typically dilute the promoter or promoter group stake. However, the qualified institutions placement route presents multiple advantages *vis-à-vis* a preferential allotment, such as:

- The pricing of the securities in a qualified institutions placement is based on a two-week price average, as opposed to the pricing requirements for a preferential allotment;
- The shareholders' resolution authorizing the qualified institutions placement is valid for one year, as opposed to a 15-day validity period for the corresponding resolution for a preferential allotment;
- Convertibles and warrants can have a maximum tenure of five years, as opposed to a maximum tenure of 18 months in a preferential allotment; and
- There is no lock-in on the securities purchased through a qualified institutions placement if they are transferred on the stock exchange, while there is a lock-in of one year in a preferential allotment.[45]

Indian Depository Receipts

In General. A foreign company or body corporate can directly participate in the Indian securities market under this route. A foreign corporation is permitted to raise capital in the Indian capital markets through the issuance of Indian depository receipts that are listed on the stock exchange. Indian depository receipts are issued by an Indian depository participant against the underlying equity shares of the foreign corporation. Recently, global banking giant Standard Charted Plc raised up to US $1 billion through Indian depository receipts.[46]

Eligibility Requirements. The eligibility criteria for Indian depository receipts are laid down under the ICDR Regulations, and the rules framed under the Companies Act by the central government. Some of the key eligibility criteria required to be satisfied by the issuing company are as follows:

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44 ICDR Regulations, Schedule XVIII.

45 ICDR Regulations, reg 91.

46 Standard Charted PLC launches first ever Indian Depository Receipt 'IDR' offer, press release, 13 May 2010, *available at* http://www.standardchartered.co.in/media-centre/pdf/2010_13_may_standard_chartered_plc_sepository_receipt_idr.pdf.

- Minimum paid-up capital and free reserves — There must be pre-issue paid-up capital and free reserves of at least US $50 million and a minimum average market capitalization (during the last three years) in its parent country of at least US $100 million;
- Continuous trading record — There must be a continuous trading record or history on a stock exchange in its parent country for at least three preceding years;
- Track record of distributable profits — There must be a track record of distributable profits (declared dividend) for at least three out of the immediately preceding five years; and
- No regulatory prohibition — The issuer may not be prohibited from issuing securities by any regulatory body.[47]

Issue Conditions. Issue size should be a minimum of INR 500 million. The minimum application amount is required to be INR 20,000. The number of underlying equity shares offered in a financial year through IDR offerings should not exceed 25 per cent of the post issue number of equity shares of the company.

A minimum of 50 per cent of the issue size is required to be allotted to qualified institutional buyers. The issuer company has the discretion to apportion the balance of 50 per cent between non-institutional investors[48] and retail individual investors, including employees of the issuer company.[49] If the issuing company does not receive a minimum subscription of 90 per cent of the offer on the date of closure, the issuing company is required to refund the entire subscription received.

Fungibility. The present regulatory framework does not permit fungibility of IDR and only allows redemption of Indian depository receipts. Indian depository receipts can be redeemed if the following two conditions are satisfied:

- They have completed one year from the date of issuance; and
- They are infrequently traded on the stock exchange in India. Indian depository receipts are deemed to be infrequently traded if the annual trading turnover in Indian depository receipts during the six months immediately preceding the

47 ICDR Regulations, reg 97.

48 Regulation 2(w) of the ICDR Regulations defines non-institutional investor as an investor other than a retail individual investor and qualified institutional buyer.

49 ICDR Regulations, reg 98(d) and (e). If at least 30 per cent of the Indian depository receipts being offered in the public issue must be available for allocation to retail individual investors and in case of under-subscription in the retail individual investor category, spillover to other categories to the extent of under-subscription may be permitted.

month of redemption is less than five per cent of the listed Indian depository receipts.[50]

Secondary Market and Takeovers

Trading

The secondary market operates through two mediums, the over-the-counter market and the exchange traded markets. The over-the-counter markets are markets where all trades are negotiated and are immediately paid for and delivered (ie, spot trades). In exchange traded markets the trade takes place with the help of the infrastructure provided by the stock exchange.

Stock exchanges in India follow a systematic settlement period. All trades taking place on a trading day (day = T) are settled together after two days (day = T+2 day). Each trade negotiated on the stock exchange is cleared by the clearing corporation that acts as a counterparty and guarantees settlement.

Stock exchanges in India offer an automated screen-based trading system wherein a participant member can register into the computer the quantities of a security and the price at which he would like to transact, and the transaction is executed as soon as a matching sale or buy order from a counter party is found.

The National Stock Exchange was the first exchange in the world to use satellite communication technology for trading, ie, the National Exchange for Automated Trading.[51]

Takeovers

In India, the capital markets regulation dealing with substantial acquisition of shares has evolved over a period of time. Pre-liberalization, the takeover regulation was incorporated in the listing agreement. A formal framework was only adopted in 1994 with the enactment of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994. The 1994 Regulations were repealed and replaced by the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997.

Post-1997, India saw enormous growth and increasing sophistication in mergers and acquisition activity. Recognising the need to revisit the 1997 regulations, the SEBI in 2009 constituted the Takeover Regulations Advisory Committee.[52] Based on the recommendation of the Takeover Regulations Advisory Committee, the SEBI formulated the present Takeover Code (in effect as from October 2011).

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50 AP (DIR Series) Circular Number 5 of 22 July 2009; SEBI Circular Number CIR/CFD/DIL/3/2011 of 3 June 2011.

51 ISMR, 'Indian Securities Market: A Review', vol XIV, 2011 (National Stock Exchange).

52 Report of the Takeover Regulations Advisory Committee, 31 August 2010.

Mandatory Open Offer

Threshold Limit. If an acquirer (along with a person acting in concert) acquires 25 per cent or more of the voting rights in a listed company in India, the acquirer is required to make an open offer to acquire at least 26 per cent shares of the total shares of the target company.[53]

This threshold limit is slightly less than the limit prescribed in most jurisdictions such as United Kingdom, Hong Kong, Singapore, and France.[54]

Creeping Acquisition. An acquirer holding 25 per cent or more voting rights in a listed company can acquire additional shares or voting rights to the extent of five per cent of the total voting rights in any financial year subject to the maximum permissible non-public shareholding limit, ie, 75 per cent. Any acquisition beyond the five per cent limit in a financial year would trigger an open offer obligation to acquire at least 26 per cent of the total shares of the target company.[55]

Control. If an acquirer acquirers control[56] over a listed company, directly or indirectly (whether through acquisition of shares, voting rights, or otherwise), the acquirer is required to make an open offer to acquire at least 26 per cent of the total shares of that listed company.

The question as to what constitutes control is a mixed question of law and fact. Some of the instances wherein control is said to have been acquired includes acquisition of the right to appoint majority of the directors, control the management, and control the policy decisions of the company.[57]

Voluntary Offer. An acquirer holding 25 per cent or more voting rights in a listed company can make a voluntary offer for at least 10 per cent of the total shares of the listed company. The acquirer, in order to avail this route of acquisition, should not have acquired the shares of the target company in the preceding 52 weeks.

As in the case of a mandatory offer, in a voluntary offer the acquirer cannot cross the maximum non-public holding threshold, ie, 75 per cent.[58]

Exemptions. Some transactions are exempt from mandatory open-offer requirements, such as:

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53 Takeover Code, reg 3(1).

54 Report of the Takeover Regulations Advisory Committee, 31 August 2010, states that in these jurisdictions the open offer threshold is 30 per cent.

55 Takeover Code, reg 3(2).

56 Regulation 2(e) of the Takeover Code defines control as 'control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner'.

57 Takeover Code, regs 4 and 5, read with reg 2(e).

58 Takeover Code, reg 6.

- Acquisition of shares by the promoters of a company from a venture capital funds or a registered foreign venture capital investor registered with the SEBI pursuant to an agreement between such venture capital funds/registered foreign venture capital investor and the promoters;
- Increase in voting rights of any shareholder pursuant to a buyback of shares provided that such shareholder has not voted in favor of the resolution authorizing the buyback and such increase in voting rights does not result in any acquisition of control by such shareholder over the target company;
- Acquisition of shares by any shareholder, up to his entitlement pursuant to a rights issue; and
- Acquisition by way of a scheme of arrangement pursuant to an order of a court or competent authority under Indian or foreign law.

This last exemption, however, is only available if the target company is directly involved in the said scheme. If the target is not directly involved, an acquisition under such a scheme is exempt subject to two conditions, ie, cash and its equivalent consideration should be less than 25 per cent of the total consideration being paid pursuant to the scheme, and persons directly or indirectly holding at least 33 per cent of voting rights in the combined entity should be the same as those who held the entire voting rights before implementation of the scheme.[59]

Disclosures

In General

Every disclosure made by a regulated entity has a cost attached to it. India, like other best practice jurisdictions, is committed to principle-based regulation.[60] India has pursued an integrated disclosure model with an objective to make disclosures meaningful, less duplicative, and less burdensome.[61]

Company Disclosure

A listed company is required to make the following periodic and event-based disclosures:

Information	Recipient	Timing
Shareholding pattern[62]	Stock exchange	Within 15 days of the end of each quarter

59 Takeover Code, reg 10.
60 SEBI (Mutual Funds) (Amendment) Regulation 2012; Report of the Committee on Financial Sector Reforms, *A Hundred Small Steps* (2009).
61 Report of the Sub-Committee on Integrated Disclosures, 21 January 2008, see http://www.sebi.gov.in/commreport/IntegratedDisclosures.pdf.
62 Listing Agreement, cl 35.

Material events, such as general change in the nature and character of the business, disruption of business activity, commencement of commercial production from which the revenue is estimated to be substantial, any litigation likely to affect the profitability or financial of the company, or any change in credit rating of the company's securities[63]	Stock exchange	Event based
Price-sensitive information, such as issue of securities, acquisition, merger, demerger or any restructuring, voluntary delisting, forfeiture of shares or information regarding opening, closing of any securities[64]	Stock exchange	Event based
Financials, quarterly, and annual financial results (audited or un-audited)[65]	Stock exchange	Within 45 days of the end of each quarter
Corporate governance report[66]	Stock exchange	Within 15 days of the end of each quarter
Disclosure of substantial holding — the details of the interest or holding of the directors of the company[67]	Stock exchange	Within two working days of the receipt of the information

Shareholder Disclosure

Shareholders of a listed company are required to make the following disclosures:

Information	Recipient	Timing
Holding of five per cent or more of shares or voting rights (and any subsequent change in holding): number of shares or voting rights held[68]	Company	Within four working days of the receipt of intimation of allotment of shares or the acquisition of shares or voting rights

63 Listing Agreement, cl 36.
64 Listing Agreement, cl 36(7).
65 Listing Agreement, cl 41.
66 Listing Agreement, cl 49.
67 Insider Trading Regulations, reg 13(6).
68 Insider Trading Regulations, reg 13(1).

Acquisition or disposal of two per cent of shares or voting rights, by an acquirer already holding five per cent or more of shares/voting rights[69]	Company and stock exchange	Within two working days of such acquisition or disposal
Creation, invocation, or release of encumbrance on shares held by the promoter or the person acting in concert[70]	Company and stock exchange	Within seven working days from the creation, invocation, or release of encumbrance
Continued disclosure of shareholding, by person holding 25 per cent or more shares or voting rights[71]	Company and the stock exchange	Within seven working days from the end of each financial year
Continued disclosure by promoter and person acting in concert of aggregate shareholding and voting rights[72]	Company and the stock exchange	Within seven days from the end of each financial year

Foreign Investor Disclosure

A foreign institutional investor is required to disclose all information concerning the parties to, and the terms of, any off shore derivative instruments (such as participatory notes and equity linked notes) entered into by the foreign institutional investor or its sub accounts relating to any listed securities and any securities proposed to be listed, in India.

The disclosure is required to be made as and when the SEBI requires such a disclosure.[73] A registered foreign venture capital investor is required to disclose its investment strategy and the life cycle of the fund before making any investment.[74]

Corporate Governance

Clause 49 of the Listing Agreement contains a complete corporate governance code for listed companies. Clause 49 mandates that at least 50 per cent of the board of directors of a listed company is to be comprised of non-executive directors.

If the chairman of the board also is the promoter or related to the promoter group, half the board of directors must comprise of independent directors. Independent directors are those that have no pecuniary interest with the

69 Insider Trading Regulations, reg 13(2).
70 Takeover Code, reg 31(3).
71 Takeover Code, reg 30(1).
72 Takeover Code, reg 30(2).
73 Foreign Investment Institution Regulations, reg 20A.
74 Registered Foreign Venture Capital Investor Regulations, reg 11(a).

company, its promoters, or its senior management and own less than two per cent of the block of voting shares. Clause 49 also requires the setting up of an audit committee.

Insider Trading and Price Manipulation

In General

Insider trading is a punishable offence in India and is regulated and monitored by the SEBI under the Insider Trading Regulations.

Extraterritorial Application

The Insider Trading Regulations apply to activities of any person who is dealing in securities of a company listed on a recognized stock exchange in India. As long as the securities in question are traded on any recognized stock exchange in India, the SEBI Insider Trading Regulations would apply, irrespective of the residence of the person in question.

Elements

In order to constitute insider trading, the following key ingredients are required to be satisfied:

- Insider — The person should be connected with the company or be deemed to be connected with the company or should have access to unpublished price-sensitive information. Typically, the directors of the company, or an officer of the company who holds a position involving a professional or business relationship between him and the company, or a group company, are considered to be insiders. The broad test is that a person is considered to be an insider if he is reasonably expected to have access to price-sensitive information.[75]
- Deal in securities — The person should have dealt in securities, i.e., the act of selling or buying securities or subscribing or agreeing to subscribe, buy, or sell securities.[76]
- Possession of unpublished price sensitive information — Such person should possess information that is not in the public domain or the market is not aware of, which has a material effect on the price of the shares and the value of the securities of the company.[77]

75 Insider Trading Regulations, reg 2(e), read with reg 2(c).
76 Insider Trading Regulations, reg 2(d).
77 Insider Trading Regulations, reg 2(ha), read with reg 2(k).

Penalty

The SEBI can impose a penalty of INR 250 million or three times the amount of profits made out of insider trading, whichever is higher.[78]

Foreign Participation in the Securities Market

In General

Post-liberalization, foreign investors have had considerable access to the Indian capital markets. As is the case in most jurisdictions, India too conceptually recognizes two classes of foreign investors, portfolio and direct. Direct investors are perceived to have a 'lasting interest' in the company whereas portfolio investors primarily trade in securities. In India, both these classes of foreign investors are permitted to participate in the securities market (primary and secondary).[79]

Foreign participation in the capital markets results in inflow and outflow of capital and is thus monitored by several government and independent agencies/regulators. The institutional bodies regulating capital flows are the Reserve Bank of India and the SEBI.

Within the government, the Foreign Investment Promotion Board and the Department of Industrial Policy and Promotion and the Department of Economic Affairs monitor and regulate foreign investment in India. Foreign participation is permitted through four routes, ie, foreign direct investment, foreign institution investment, registered foreign venture capital investor, and qualified foreign investors.

Foreign Direct Investment

In General

Under the foreign direct investment route, non-residents can invest in shares, mandatorily and fully convertible debentures, and mandatorily and fully convertible preference shares of an Indian company.[80] Depending on the amount of investment and the industry in which the Indian company is operating, the investment may be permitted either through the automatic route or the government route.

In case the investment falls under the automatic route, no approval from the Reserve Bank of India or the government of India is required. Investment falling

78 Securities and Exchange Board of India Act, 1992, s 15G.

79 Reserve Bank of India Master Circular Number 15/2012-13 of 2 July 2012; Report of the Working Group on Foreign Investment, 30 July 2010, see http://www.finmin.nic.in/reports/WGFI.pdf.

80 Consolidated Foreign Direct Investment Policy, Circular Number 1 of 2012, Department of Industrial Policy and Promotion.

under the government route would, however, require prior approval from the Foreign Investment Promotion Board.

For almost a decade, the government has applied the policy that permits foreign direct investment in all sectors (subject to certain sectoral caps and other conditions) except those that are expressly prohibited. Foreign direct investment is expressly prohibited in the business of chit funds, agricultural and plantation activities, atomic energy, multi-brand retailing, trading of transferable development rights, real estate business, and other sectors in which private participation in not permitted.[81]

Foreign Direct Investment and Primary Markets

Public Issue and Private Placement. A non-resident entity can subscribe to the fresh issue of shares of a listed Indian company subject to compliance with the pricing requirements under the ICDR Regulations. In other words, a foreign entity is permitted to participate in an initial public offering or a follow-on public offering process through the foreign direct investment route.

Depending on the sector in which the Indian company operates, the investment also may be subject to minimum capitalization norms, lock-in requirements, or other additional sectoral requirement. For instance, a non-resident is permitted to invest in an Indian company engaged in the business of construction development up to 100 per cent under the automatic route, subject to some restrictions, such as a minimum capitalization of US $10 million in the case of a wholly owned subsidiary and US $5 million for joint ventures with Indian partners and lock-in of the original investment for three years from the completion of minimum capitalization.

Rights Issue. A non-resident entity is eligible to participate in the rights issue of a listed Indian company subject to the sectoral caps and other requirements under the Foreign Exchange Management Act.

Foreign Direct Investment and Secondary Markets

A non-resident can purchase listed securities from an Indian resident entity directly subject to the pricing requirements prescribed under the Foreign Exchange Management Act. As mentioned above, pricing requirements are not applicable for transfer of securities between two non-residents. In case the purchase exceeds thresholds specified in the Takeover Code, the non-resident would be required to make an open offer. It should be noted that an investor cannot trade in securities under the foreign direct investment route.

81 Consolidated Foreign Direct Investment Policy, Circular Number 1 of 2012, Department of Industrial Policy and Promotion.

Foreign Direct Investment and American Depositary Receipts and Global Depositary Receipts

In General. Depository receipts are negotiable securities issued outside India by a depository bank, on behalf of an Indian company. The underlying securities of the depositary receipts are the rupee-denominated equity shares of the company. These equity shares are held by the custodian bank in India. Depositary receipts are traded on stock exchanges such as those in the United States, Singapore, Luxembourg, and London. Depositary receipts listed and traded in the United States markets are known as American depository receipts, and those listed and traded elsewhere are known as global depository receipts.

An Indian company can raise foreign currency resources abroad through the issuance of American depositary receipts and global depositary receipts in accordance with the Scheme for Issue of Foreign Currency Convertible Bonds and other Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993, and guidelines issued by the government of India from time to time. An Indian-listed company can issue American and global depositary receipts if it is eligible to issue shares to person resident outside India under the foreign direct investment scheme and it is eligible to raise funds from the Indian capital market.

An Indian company also may sponsor an issue of American and global depositary receipts. Under this mechanism, the company offers its shareholders a choice to tender their shares, so that on the basis of such shares, American and global depositary receipts can be issued abroad. The proceeds of the American or global depositary receipts issue are remitted back to India and distributed among the shareholders who had offered their shares.[82]

As a general rule, the proceeds of American depositary receipts or global depositary receipts are required to be kept abroad till they are required in India. Until they are repatriated to India, the Indian company can invest the funds *inter alia* in treasury bills and monetary instruments with a maturity period of less than one year.

Mode of Payment. A foreign entity that purchases or subscribes to the securities of an Indian company can make payment through normal banking channels. The foreign entity can adjust the consideration for the issue of shares against any royalty or technical fee that may be due from the Indian company.

The foreign entity also may make payment for the issue of shares under a share-swap arrangement with the prior approval of the Foreign Investment Promotion Board.

To facilitate transactions under the foreign direct investment route, authorized banks have been permitted to open and maintain non-interest-bearing escrow

82 Consolidated Foreign Direct Investment Policy, Circular Number 1 of 2012, Department of Industrial Policy and Promotion, para 3.3.4.

accounts in Indian Rupees on behalf of non-residents and residents towards payment of share purchase consideration or for holding securities.

Reporting Requirements. An Indian company must report any foreign direct investment to the Reserve Bank of India within 30 days from the date of receipt, and file certain forms and documents with dealers authorized by the Reserve Bank of India.

Similarly, transfer of securities from residents to non-residents or vice versa must be reported to the authorized dealer within 60 days from the date of receipt of the consideration for the transfer.[83] These requirements are in addition to the reporting requirement(s)/disclosures that an investor/acquirer is required to comply with and mentioned above.

Foreign Institutional Investors

In General. Foreign corporations, funds, or individuals who meet the criteria for registering as a foreign institutional investor or sub-account, and are registered under the Foreign Institutional Investment Regulations, are allowed to invest in the securities of an Indian company under the portfolio investment scheme subject to specified ceilings.

Permissible Investments. Foreign institutional investors are allowed to participate in primary and secondary markets, and invest in securities such as shares, debentures, and warrants of companies unlisted, listed, or to be listed on a recognized stock exchange in India under the portfolio investment scheme subject to specified investment ceilings.

In particular, an individual foreign investment institution is permitted to invest in the securities of an Indian company up to a maximum limit of 10 per cent of the total paid up equity capital of the company.

The overall limit for foreign institutional investment in a listed company is capped at 24 per cent of the total paid-up equity capital of the Indian company. The aggregate limit of 24 per cent can be increased to the sectoral cap (as applicable in case of foreign direct investment) through a special resolution of the shareholders of the Indian company.[84]

Additionally, the SEBI-registered foreign institutional investors are also eligible to invest in other instruments, such as listed or unlisted units of schemes floated by domestic mutual funds, government securities, derivatives traded on a recognized stock exchange, commercial paper, security receipts, and Indian depository receipts.[85]

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83 Consolidated Foreign Direct Investment Policy, Circular Number 1 of 2012, Department of Industrial Policy and Promotion, para 7.2.3.

84 Consolidated Foreign Direct Investment Policy, Circular Number 1 of 2012, Department of Industrial Policy and Promotion, para. 3.1.4; Foreign Investment Institution Regulations, reg 15(1)(a).

85 Foreign Institutional Investment Regulations, reg 15.

Although foreign institutional investors are permitted to invest freely in debt and equity instruments, the total investments by foreign institutional investors in equity instruments cannot be less than 70 per cent of the aggregate of all the investments made by the foreign institutional investment in India. However, the SEBI may grant approval to any foreign investment institution for investment in debt instruments beyond the prescribed limit.[86]

Foreign Institutional Investors and Primary Market. The SEBI registered foreign institutional investors are permitted to participate in an initial public offering, follow-on public offering, or any other primary market process including qualified institutions placement. The price at which the shares are issued to the foreign institutional investors is required to be not less than the price at which the shares are issued to residents.

Foreign Institutional Investors and Secondary Market. Foreign institutional investors are permitted to freely purchase and sell listed securities in the secondary market. Foreign institutional investors can transact in the secondary market by taking delivery of securities purchased and giving delivery of securities sold. Furthermore, foreign institutional investors or sub accounts are also permitted to sell stocks not owned by them at the time of trade (in market parlance known as 'short selling').[87] Foreign institutional investors can transact in the secondary market only through the SEBI registered stockbrokers.

Foreign institutional investors are unlikely to trigger the Takeover Code as the individual ceiling limit for foreign institutional investors is capped at 10 per cent and the aggregate limit is capped at 24 per cent, both of which are less than the mandatory open offer trigger under the Takeover Code (25 per cent).

Foreign Institutional Investors and Overseas Derivative Instruments. Foreign institutional investors are permitted to issue foreign instruments against securities held by them that are listed or are proposed to be listed on any recognized stock exchange (as its underlying) in India, to persons who are regulated by foreign central banks or foreign futures or securities regulators.

Foreign institutional investors are required to comply with the SEBI prescribed 'know your client' norms in connection with such instruments. This route was made available for non-resident investors who, although wishing to access the Indian securities market, were precluded from doing so due to regulatory requirements.[88]

Registered Foreign Venture Capital Investors

Registered foreign venture capital investors are required to invest at least two-thirds of their funds in unlisted equity-linked securities of a company, and up to

86 Debt securities in this context would mean dated government securities, commercial paper, and treasury bills.
87 AP (DIR Series) Circular Number 23 of 31 December 2007.
88 Foreign Investment Institution Regulations, reg 15A.

one-third of their funds in listed securities. In particular, registered foreign venture capital investors may invest by way of:

- Subscription to initial public offering of a domestic company whose shares are proposed to be listed;
- Debt or debt instrument of a company in which the registered foreign venture capital investor has already made an investment by way of equity; and
- Preferential allotment of equity shares of a listed company subject to a lock-in period of one year.[89]

Until recently, there was ambiguity on two counts for registered foreign venture capital investors: one, the ability of registered foreign venture capital investors to purchase existing shares from existing investors/shareholders under the registered foreign venture capital investor route, as against fresh issuance of new shares by a company which was clearly permitted; second, whether registered foreign venture capital investors can make investments in listed securities.

In March 2012, the Reserve Bank of India clarified that registered foreign venture capital investors can invest in securities of a foreign venture capital by way of purchase from a third party. The Reserve Bank of India also clarified that registered foreign venture capital investors would be allowed to invest in securities on a recognized stock exchange subject to the restrictions and conditions laid down in the SEBI Registered Foreign Venture Capital Investor Regulations.[90]

Qualified Foreign Investors

Qualified foreign investors are non-resident persons who are not registered with the SEBI as a foreign investment institution, sub account, or registered foreign venture capital investor, and who comply with the SEBI's 'know your customer' requirements. They are permitted to invest in equity and debt schemes of domestic mutual funds and listed and to-be-listed equity shares of Indian companies.

Qualified foreign investors are permitted to invest only in equity shares of listed Indian companies through recognized brokers on recognized stock exchanges in India, as well as in equity shares of Indian companies which are offered to the public in India in terms of the relevant and applicable SEBI guidelines/regulations. This includes rights and bonus shares.

Qualified foreign investors can sell their holding only through brokers on a recognized stock exchange, in an open offer under the Takeover Code, through buyback of shares by the company under the SEBI buyback regulations, or in an open offer under the SEBI delisting regulations.

89 Registered Foreign Venture Capital Investor Regulations, reg 11.
90 AP (DIR Series) Circular Number 93 of 19 March 2012.

An individual qualified foreign investor is only permitted to invest up to a maximum of five per cent of the total paid-up equity capital of the company. The aggregate shareholding of all qualified foreign investors in an Indian company is capped at 10 per cent of the total paid-up equity capital of the company, in respect of each class of shares. The limits are over and above the foreign investment institution and non-resident Indian investment ceilings prescribed under the portfolio investment scheme. However, where composite sectoral caps are prescribed under the foreign direct investment scheme, the limits for qualified foreign investor investments is required to be within such overall limits.

Qualified foreign investors like foreign institutional investors can transact in Indian equity shares only on the basis of taking and giving delivery of shares purchased or sold. Qualified foreign investors are not permitted to issue offshore derivative instruments or participatory notes.

Typically, the qualified foreign investor is required to place a purchase order with the depository participant, mentioning the name of the company, number of equity shares, and name of the stock broker, and transfer the foreign inward remittance from a designated overseas bank account to a single rupee bank account of the depository participant in any permitted currency. Thereafter, the depository participant forwards the purchase order and remits the money to the SEBI registered stockbroker. The purchase must be made within four working days, otherwise the depository participant is required to remit the money back to the overseas account of the qualified foreign investor. In case the purchase is made within five working days, the depository participant is required to credit the purchased equity shares in the qualified foreign investor's dematerialized account.

In order to facilitate transactions under the qualified foreign investor scheme, the depository participant is permitted to maintain a separate single rupee pool bank account. The sale proceeds of the equity shares received in the single rupee pool bank account of the depository participant can be repatriated to the overseas bank account of the qualified foreign investor.

Alternatively, the sale proceeds also can be utilized for fresh purchases of equity shares within five working days. Dividends declared on the equity shares held by the qualified foreign investor can be either remitted in the single rupee pool account or directly remitted to the qualified foreign investor's overseas bank account.

Jurisdictional Conflict

Conflict of Jurisdiction

Under the Indian Constitution, the Indian Parliament is vested with the power to enact extra territorial legislation so long as the legislation has some territorial nexus with India. Several regulators overseeing the Indian economy are armed with extra territorial powers, such as the Competition Commission of India. The

SEBI has a statutory duty to protect the interest of investors in securities, and to promote the development of, and to regulate, the securities market.

In order to fulfil this mandate the SEBI has been given plenary powers to regulate, monitor, and penalize all persons 'associated with the securities market'. The term persons 'associated with securities market' has not been defined in the SEBI Act.

However, judicial precedents have held that persons 'associated with the securities market' not only includes stock exchanges, mutual funds, and other intermediaries but also includes a buyer and seller of securities listed or to be listed on the stock exchange. In other words, any person who has any association with the Indian securities market will come within the regulatory purview of the SEBI irrespective of the person's nationality or residence.[91]

In a recent instance, one of the entities, while being scrutinized by the SEBI, had contended that the entity was involved only in the listing of global depositary receipts (underlining shares were that of Indian companies) in a relevant exchange outside India and thus cannot be treated as a person 'associated with the securities market' in India as it was neither registered as an intermediary with the SEBI nor was involved in the buying and selling of Indian securities.

On a close examination, the SEBI held that it had the jurisdiction to regulate the entity on the reasoning that global depositary receipts are instruments which derive their existence from securities listed in the Indian stock markets and any structuring or manipulation related to global depositary receipts would have impact on the stocks of the companies trading in the Indian market. This case further demonstrates that the SEBI is vested with wide extra-territorial jurisdiction in all matters connected with the Indian securities market.[92]

Multilateral Approaches

Since independence, India has been an active participant in international policy initiatives, and this has been further accelerated in the last three decades with the liberalization of the Indian economy. India has actively participated in the consultative process on financial regulation conducted under the auspices of the Basel Committee on Banking Supervision. The Reserve Bank of India issues guidelines and circulars from time to time in order to comply with the Basel accord.

India has been a member of the Financial Action Task Force since 2010. The Financial Action Task Force is an inter-governmental body which was established in 1989 to set standards and promote effective implementation of legal, regulatory, and operational measures for combating money laundering,

91 *Karnavati Fincap Limited v Securities and Exchange Board of India,* 1996 (87), Comp Cases 186 Gujarat.

92 *In the Matter of Alleged Market Manipulation Using GDR Issues Against Pan Asia Advisors Limited and Mr Arun Panchariya*, WTM/PS/ISD/JAN/2012.

terrorist financing, and other related threats to the integrity of the international financial system.

In 2010, the Financial Action Task Force and the Asian/Pacific Group on Money Laundering jointly conducted an assessment of the implementation of anti-money laundering and counter terrorist financing standards in India and they found that:

'India has progressively expanded and strengthened its preventive measures for the financial sector, which now apply to all but one of the financial activities required to be covered under the Financial Action Task Force standards. However, several preventive provisions need to be brought more closely into line with the Financial Action Task Force standards, and overall, more time is needed before all requirements are substantially implemented. The supervisory regime for financial institutions is generally sound, but its effectiveness with regard to AML/CFT has not yet been sufficiently demonstrated. In addition, the sanctions that supervisors have applied for AML/CFT deficiencies cannot be considered to be effective, dissuasive or proportionate.'[93]

India is actively engaged in the preparation of harmonization principles in securities market under the auspices of the International Organization of Securities Commissions. India has complied with almost all the 30 principles laid down by the International Organization of Securities Commissions, which include principles regarding independence of regulator, self-regulation, cooperation, and stake holder participation in regulation making, and minimum entry standards for market intermediaries.

93 Asian/Pacific Group on Money Laundering and Financial Action Task Force, Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing Terrorism', 25 June 2010, see http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER per cent20India per cent20ES.pdf.

Ireland

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Ireland

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Dublin, Ireland

Introduction

In General

Ireland is a sovereign parliamentary democracy, with Dublin as its capital city. The 1937 Constitution established the state's modern legal system and thereby supplanted the Irish Free State Constitution of 1922. Prior to 1922, Ireland was part of the United Kingdom and thus was governed by the British Parliament in London from 1802 onwards.

The British and Irish governments enacted the Irish Free State Constitution in 1922 pursuant to the Anglo-Irish Treaty signed in 1921. A new constitution was drafted, put to the people by way of referendum for their approval, and enacted in 1937. The 1937 Constitution is the sole basis for the validity of the institutions of the state, including the court system, and is the ultimate source of legal authority, except for legislation deriving from the European Treaties.

Regulatory System

The legal system is based on the Common Law, similar to that of the United Kingdom, but with the addition of a written constitution. The Constitution enumerates the powers of government as of three distinct types, legislative, executive, and judicial.[1]

These powers are exercised by the principal organs of the state, ie, the President, the Government (the Executive), the *Oireachtas* (the Legislature), and the Judiciary.

The President is the formal head of state and undertakes the important role of protector of the Constitution, although this role is primarily of ceremonial function.

Whereas the President is under an obligation to act only on the advice of government regarding the appointment of the *Taoiseach*[2] and members of the judiciary, he may at his own discretion refer any Bill (other than a Money Bill, ie, a Bill published to implement the Budget) of the *Oireachtas* to the Supreme Court for determination as to its constitutionality.

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1 Kelly, *The Irish Constitution* (1984).
2 The Prime Minister or Head of Government.

The *Oireachtas* is vested with the 'sole and exclusive power of making laws for the state'[3] and comprises two houses of parliament (a house of representatives, the *Dáil*, and a senate, the *Seanad*), together with the President. The *Dáil* is composed of elected members, known as 'TDs', who represent a defined constituency. The *Seanad* is composed of members, senators who are nominated by the *Taoiseach*, elected by vocational panels representing special interests and services in the state, or elected by university panels. In general, legislation originates in the *Dáil* and is then sent to the *Seanad* for consideration.

The government exercises all executive powers of the state, but is answerable to the *Dáil*. The members of government and Ministers are appointed by the President on the advice of the *Taoiseach* and may number not less than seven and not more than 15. The *Taoiseach* nominates a member of the government to be the *Tánaiste* (Deputy Prime Minister), who acts in the place of the *Taoiseach* when he is incapacitated or absent from office.

Although the government may contain up to a maximum of two members of the *Seanad*, the *Taoiseach*, *Tánaiste*, and the Minister for Finance must be members of the *Dáil*. Government functions by way of the cabinet system through individual and collective ministerial responsibility. In addition to government Ministers, Ministers of State are appointed to assist the Ministers in their departmental and parliamentary work. However, Ministers of State do not constitute members of government.

Article 35.2 of the Constitution reaffirms judicial independence, providing that 'all judges shall be independent in the exercise of their judicial functions and subject only to this Constitution and the law'. The appointment of members of the judiciary is within the realm of the executive, in so far as the government nominates a judge to the President who, in turn, gives effect to the appointment. A judge can only be removed from office for misconduct or incapacity or on reaching the age of retirement.

Court Authorities

The courts provide the framework for the functioning of the judiciary and can be differentiated on the basis of jurisdiction, ie, criminal and civil.

The District Court is the lowest court. The Circuit Court has original and appellate jurisdiction. The High Court has original and unlimited jurisdiction. This court may sit consisting of one judge or three, as decided by the President of the High Court.

The Supreme Court is the final court of appeal. It consists of the Chief Justice and six other judges, in addition to the President of the High Court who is a member *ex officio*. This court may sit as three judges or five judges. The Supreme Court has original jurisdiction regarding the constitutionality of a Bill referred to it by the President.

An appeal to the Circuit Court results in a complete rehearing of the case, and either party may introduce new evidence. Appeals from the District Court lie to the Circuit Court,

3 Constitution 1937, art 15.2.1.

except an appeal by way of case-stated to the High Court. Appeals from the Circuit Court lie to the High Court, except by way of case-stated to the Supreme Court.

Sources of Law

The primary and fundamental source of law is the Constitution. Legislation passed by the *Oireachtas* and legislation passed by previous legislatures,[4] which is still in force, is the second source of law. The final source of law, in accordance with Ireland's membership in the European Union (EU) and through the Treaty of Rome, is European Union legislation.

Acts, such as the Stock Exchange Act 1995,[5] originate in the *Oireachtas*. However, 'delegated legislation', whereby government departments are empowered by an Act to draw up statutory instruments, eg, the European Communities (Stock Exchange) (Amendment) Regulations 1991,[6] is made by the relevant Minister under the powers conferred on him, eg, by the European Communities Act 1972.[7]

Ireland joined the European Economic Community in 1972 by amendment of the Constitution by way of referendum. Accordingly, a right of appeal exists from the Irish courts through to the European Court of Justice. This reflects the primacy of EU law over national legislation.

Ireland operates according to the Common Law legal system, which means that the doctrine of precedent and *stare decisis* apply. The doctrine of *stare decisis* is applied in relation to the operation of judicial precedent. Each court is bound by its own previous decisions and by the decisions of a superior court, in so far as the court is dealing with a principle of law applying to similar cases. As a result, decisions of the superior courts are an important secondary source of law.

Admission to the Irish Stock Exchange

Irish Stock Exchange

There has been a stock exchange based in Dublin since 1799. The Irish Stock Exchange was founded by an Act for the Better Regulation of Stockbrokers (Ireland) Act 1799. The present stock exchange results from the merger of the Dublin Stock Exchange and the Cork Stock Exchange in 1971. Between 1973 and 1995, this combined exchange comprised the Irish unit of the International Stock Exchange of the United Kingdom and the

4 These include the Irish Free State Government, 1922–1937, and the Parliament of the United Kingdom of Great Britain and Ireland, 1802–1922.
5 Stock Exchange Act 1995, Act Number 9 of 1995.
6 European Communities (Stock Exchange) (Amendment) Regulations 1991, SI Number 18 of 1991.
7 European Communities Act 1972, Act Number 27 of 1995. Since 1 May 2000, the United Kingdom Listing Authority has been transferred from the London Stock Exchange to the Financial Services Authority. This chapter will continue to refer to the Yellow Book of the United Kingdom.

Republic of Ireland. Since 1995, the Irish Stock Exchange has been a separate entity, although the listing rules applied by it largely follow the Listing Rules of the Financial Services Authority, ie, 'The Purple Book'.

The main elements of the regulatory regime for the admission and securities dealing comprise:

- European Directives;
- Irish Companies Acts;
- Take-over Rules made by the Irish Panel on Take-overs and Mergers;
- Stock Exchange Act; and
- Investment Intermediaries Act.[8]

The Irish Financial Services Regulatory Authority is the regulatory supervisory authority for the Irish Stock Exchange under the terms of the Stock Exchange Act 1995. It also regulates the member firms of the Exchange. However, the Irish Stock Exchange is autonomous in its capacity as a listing authority. As a full member of the EU since 1972, European Council Directives[9] have application in Ireland, and they are typically introduced into domestic Irish law by way of statutory instrument.[10]

The Stock Exchange Act 1995 defines a stock exchange as an organized financial market whose members provide an investment service[11] in respect of investment instruments,[12] but excludes an exchange involved wholly or mainly in financial futures or options which would fall to be regulated under the Central Bank Act 1989.[13] The Irish Financial Services Regulatory Authority, in approving a stock exchange, must be satisfied, *inter alia*, as to:

- Due incorporation;
- Minimum level of capital;
- Suitability of controlling shareholders;
- Location of registered and head offices; and
- Members of the board, including independent members.

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8 Companies Acts 1963–2003, as amended; Stock Exchange Act 1995, Act Number 9 of 1995; and Investment Intermediaries Act 1995, Act Number 11 of 1995.

9 Admissions Directive (Council Directive 79/279/EEC), Capital Adequacy Directive (Council Directive 93/6/EC), Listing Particulars Directive (Council Directive 80/390/EEC), Investment Services Directive (Council Directive 93/22/EC), Interim Reports Directive (Council Directive 82/121/EEC), and Prospectus Directive (Council Directive 89/298/EEC).

10 A statutory instrument is an order or regulation made by a government minister under a power granted by statute. In the case of the above Directives, the power derives from section 3 of European Communities Act 1972 (Act Number 27 of 1972).

11 'Investment services' include dealings with investment instruments on behalf of others or on own account.

12 'Investment instruments' include transferable securities, units of shares in UCITS, financial futures contracts, swaps, debentures, and governmental or public securities. Cheques, bankers drafts, bank notes, and acknowledgement of indebtedness in respect of payment for goods or services are not included.

13 Central Bank Act 1989, Act Number 16 of 1989.

The Irish Financial Services Regulatory Authority also regulates member firms, ie, persons who are members of the stock exchange and whose regular occupation or business is the provision of investment services on a professional basis on or off the floor of the Exchange. There are currently approximately 20 member firms of the Irish Stock Exchange. A member firm must be approved by the Irish Financial Services Regulatory Authority under the Stock Exchange Act 1995. The fundamental principles of proper practice for member firms[14] provide that member firms must:

- Act honestly and fairly in the best interests of clients and the integrity of the market;
- Act with due care, skill, and diligence in the best interests of clients and the integrity of the market;
- Have and apply effectively the resources and procedures that are necessary for the proper performance of their business activities;
- Seek from clients information regarding their financial situation, investment experience, and objectives as regards the services requested;
- Make adequate disclosure of relevant material and information in their dealings with clients;
- Make a reasonable effort to avoid conflicts of interest and, when they cannot be avoided, ensure that its clients are fairly treated; and
- Comply with all regulatory requirements applicable to the conduct of their business activities so as to promote the best interests of clients and the integrity of the market.

Domestic Markets

In General

There are currently two securities exchanges operating in Ireland, ie, the Irish Stock Exchange and FINEX (see text, below). The Irish Stock Exchange provides a market for securities ranging from government bonds, investment funds, corporate bonds, equities, and local authority's securities.

The market is order, rather than quote, driven. There are seven approved market makers in the government bonds market, who are authorised by the National Treasury Management Agency.[15] The Exchange has several hundred investment funds, many of which are restricted from offering units to Irish resident investors as they are managed by companies operating from the International Financial Services Center[16] in Dublin.

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14 Stock Exchange Act 1995, s 38, and the Irish Stock Exchange Rules (the Green Pages).

15 National Treasury Management Agency Act 1990, Number 18 of 1990.

16 The International Financial Services Centre is a zone in the former Dublin Docklands promoted by the Irish state for the development of financial services activities. Companies carrying on qualifying activities for export can obtain a certificate entitling them to qualify for a low rate of corporation tax. Companies which set up under the original IFSC incentive scheme benefit from a reduced rate of 10 per cent until the end of 2005. Companies which obtained a certificate after July 1998 benefited from the reduced rate until December 2002; these companies are now taxed at the standard 12.5 per cent along with all companies which set up in the IFSC since December 2000. Typical activities include treasury and fund management and asset finance.

Markets Operated by the Irish Stock Exchange

Official List. The main equities list is the Official List, and it comprises shares of approximately 15 companies at present. The index of listed shares is known as the ISEQ Index, the Irish Stock Exchange Quotient. The listing requirements and continuing obligations, *inter alia*, of companies seeking a listing are set out in the Purple Book comprising the Listing Rules of the Financial Services Authority, as amended by supplemental pages published by the Irish Stock Exchange, known as the Green Pages.

Admission to the Official List market requires publication of listing particulars, governed by the Listing Particulars Directive.[17] The Irish Stock Exchange fulfills the role of 'competent authority' for the purposes of the Admissions Directive.

Exploration Securities Market. This market has separate admission rules, the Exploration Securities Market Rules. An 'exploration company' is a company that is principally active or plans to be active in the exploration for and/or the extraction of mineral resources, a material part of which activity is carried on in Ireland.

What is considered material is a question of negotiation with the Irish Stock Exchange in each individual case. The company need not be an Irish registered company, but it is required to be a public limited company according to its laws of incorporation. At least one year's trading accounts are required prior to application for admission together with a report demonstrating that the company is engaged or has engaged in some exploration activities. At least 10 per cent of the shares of each class seeking admission must be in public hands at the time of admission unless the Irish Stock Exchange agrees otherwise.

Developing Companies Market. The Developing Companies Market is for companies seeking a quotation and listing facility that are not in a position to match the requirements of the Official List.

This market is a second-tier market imposing less rigorous disclosure requirements than the Official List. Separate admission rules, the Developing Companies Market Rules, apply to this market. The essential qualification requirements are:

- One year's trading record is required, but this requirement may be waived in certain circumstances;
- A sponsor, who must be a member firm of the Irish Stock Exchange, must be retained to take responsibility for advising the company on compliance with the Developing Companies Market rules;
- At least 10 per cent of each class of share seeking to be admitted to the market must be in public hands; and

17 Ireland implemented the Admissions Directive by the European Communities (Stock Exchange) Regulations 1984 (SI Number 282 of 1984), which were amended by the European Communities (Stock Exchange) (Amendment) Regulations 1991 (SI Number 18 of 1991). The regulations entitle the Irish Stock Exchange to apply more onerous requirements on admission or as continuing obligations for issuers than are required under the terms of the Directive.

- The admission document must disclose a range of information about the company, including information regarding directors, senior management, nature and duration of activities, controlling shareholders, trading accounts, and other relevant information, as required by chapter 3 of the Developing Companies Rules of the Irish Stock Exchange.

The Irish Stock Exchange approves the admission document but does not accept responsibility for its contents.[18] Directors are required to attach a responsibility statement to the admission document.

It is important to note that the Exploration Securities Market and the Developing Companies Market do not comprise part of the Official List. Accordingly, it is the Prospectus Directive and Irish company law[19] in the case of companies incorporated outside Ireland that determine the form and content of prospectuses to be issued when shares are to be offered to the public by companies quoted on or applying to be quoted on either markets.

FINEX

FINEX was established in 1985 as the financial futures division of the New York Cotton Exchange[20] and expanded to Europe, to Dublin, in June 1994. The Dublin trading floor, when combined with the original New York floor, creates a currency futures and options market on two continents every day.

The market is regulated independently by the Central Bank under the Central Bank Act 1989 and by the Commodity Futures Trading Commission, a United States Government Agency. FINEX trades a broad range of Euro-based contracts, United States dollar currency-paired contracts, cross-rate currencies, and the United States dollar index on an open outcry system.

Transformer Electronic Trading Systems and Other Markets

Irish residents have access to foreign securities markets primarily through Irish-based 'investment business firms'. Firms providing 'investment business services' operating within Ireland are regulated by the Irish Financial Services Regulatory Authority under the Stock Exchange Act 1995 (as amended by the Central Bank and Financial Services Authority of Ireland Act 2003)[21] in the case of member firms of the Irish Stock Exchange, and the Investment Intermediaries Act 1995[22] which, between them, implemented the Investment Services Directive.

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18 The Developing Companies Market is often compared with the Alternative Investment Market of the London Stock Exchange. However, the Developing Companies Market Rules differ from the Alternative Investment Market Rules in a significant respect; the rigorous review process conducted by the Irish Stock Exchange is often cited by investors as an attraction of the Developing Companies Market.

19 Companies Act 1963, Act Number 33 of 1963, Part XIII.

20 The New York Cotton Exchange merged in 1998 with the New York Coffee, Sugar, and Cocoa Exchange.

21 Central Bank and Financial Services Authority of Ireland Act 2003, Number 12 of 2003.

22 Investment Intermediaries Act 1995, Act Number 9 of 1995 , as amended by the Central Bank and Financial Services Authority of Ireland Act 2003.

Irish investors may access the international markets through Irish stockbroking firms that are members of both the Irish Stock Exchange and the London Stock Exchange or other exchanges, such as EASDAQ. Alternatively, Irish investors may deal with an investment business firm authorised to act as an intermediary for suitable classes of investment instruments, which may include securities dealt in or on other foreign markets. Irish investors also may deal with investment business firms authorised and regulated in their home jurisdiction within the EU and permitted to provide their services in Ireland under the Investment Services Directive.

The Irish Stock Exchange operates within an electronic settlement system, known as 'CREST', jointly with the London Stock Exchange. Irish investors may place orders through electronic trading systems, eg, using the Internet, although the investor must initiate this activity, as it is illegal to advertise 'investment business services' or to offer securities to the public other than through a regulated stockbroker or investment business firm, or by means of a prospectus or listing particulars prepared and published in accordance with the relevant legislation discussed above.

Off-Market Transactions

In general, off-market transactions are not regulated and parties are free to negotiate terms and deal freely. However, there are some exceptions to this:

- No offer of shares in a company may be made to the public without a prospectus or, in appropriate cases (ie, where the shares are dealt in on the Official List), listing particulars which have been published[23] and filed with the Companies Registration Office;[24]
- Off-market transactions in Irish Stock Exchange quoted securities must be reported to the relevant market;
- Companies whose securities are not freely tradable, ie, not public limited companies, may have internal procedural requirements or restrictions on tradability;
- Industry-specific regulation and general competition law, antitrust, and merger control restrictions may apply; and
- Irish stamp duty will be payable.

Taxes

Ireland imposes a transfer stamp duty at the rate of one per cent of the price paid or, if greater, in transactions not at arm's length, at market value, and on transfers of marketable securities, including shares in Irish registered companies. Irish companies are obliged by law to maintain their share register in Ireland so that this duty may be collected.

23 Companies Act 1963, s 51, on Irish incorporated companies; Companies Act 1963, s 361, on companies incorporated outside Ireland, and Regulation 21(3), European Communities (Transferable Securities) and Stock Exchange Regulations 1992, SI Number 202 of 1992.

24 The meaning of 'offer to the public' is not fully defined, and it is subject to specific consideration in any doubtful case.

Typically, Irish companies trading on North American securities markets have issued shares to a trustee, who holds in trust for a custodian who, in turn, issues a depositary receipt to the investor reflecting an underlying security. This system speeded up settlement of paper-based transactions. The knock-on effect was that the Irish register was not altered when a depositary receipt was traded, thus avoiding the charge to stamp duty.

Irish stamp duty can, in certain cases, be extraterritorial in effect, and care must be taken to ensure that no charge to tax arises in the ordinary course of dealings in securities on the Irish markets or that the tax is correctly administered.

Securities

National Treatment and Reciprocity

The primary pieces of legislation to be considered when making any public offer of securities in Ireland are the Companies Acts 1963–2003 and the European Communities (Transferable Securities) and Stock Exchange Regulations 1992,[25] which together set out the legal requirements relating to prospectuses to be published in conjunction with such public offers. The Regulations are to be construed as one with the Companies Act, as amended.

Part III of the Companies Act deals with prospectuses, regulates the issue of shares in or debentures of a company under Irish law, and sets out the matters to be stated and reports to be set out in a prospectus. Regulation 6 of the European Communities (Transferable Securities) and Stock Exchange Regulations 1992 provides that, subject to Regulation 21[26] thereof, it will not be lawful to issue any form of application for securities of a company unless the form is issued with a prospectus which complies with the Regulations and does not contravene section 46 of the Companies Act 1963. Regulation 6 does not apply to the types of offers and securities described in article 2 of the Prospectus Directive or to the securities referred to in article 5 of the Prospectus Directive.[27]

Under section 44(3) of the Companies Act 1963, it is not lawful, subject to certain exceptions,[28] to issue any form of application for shares in or debentures of a company, unless:

- The form of application is issued with a prospectus which complies with the requirements of Part III of the Companies Act; and

25 European Communities (Transferable Securities) and Stock Exchange Regulations 1992, SI Number 202 of 1992, which give effect to Council Directive 89/298/EEC (the Prospectus Directive) and Council Directive 90/211/EEC, which amends Directive 80/390/EEC in respect of the mutual recognition of public-offer prospectuses as stock-exchange listing particulars.

26 Regulation 21 deals with the non-application of certain sections of the Companies Act 1963.

27 European Communities Transferable Securities and Stock Exchange Regulations 1992, reg 7.

28 Companies Act 1963, s 44(4), dealing with underwriting agreements and offers not made to the public; s 44(7)(b), dealing with the issue of shares of or debentures in a company which are in all respects uniform with shares or debentures issued within the preceding two years and, for the time being, dealt in or quoted on a recognised stock exchange; and s 45(1), regarding unduly burdensome exceptions.

- Where a prospectus includes a statement purported to be made by an expert, the expert has not withdrawn his consent and a statement that the expert has given and has not withdrawn his consent appears in the prospectus.[29]

The section does not apply if the form of application was issued:

- In connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares; or
- In relation to shares or debentures which are not offered to the public.[30]

One of the first questions, therefore, to consider is whether any of the exceptions will apply to the proposed issue. More frequently than not, this will turn on whether the issue will involve an offer to the public.

An offering of shares to the public is construed as meaning an offer to any section of the public whether selected as members or debenture holders of the company concerned.[31] An offer will not be to the public if it can be regarded as not being calculated to result in the shares becoming available for subscription or purchase by persons other than those receiving the offer or invitation or otherwise being a domestic concern of the persons making and receiving it.[32]

The problems associated with what is encompassed in an offer to the public is emphasized in the Prospectus Directive, which states in its preamble 'whereas, so far, it has proved impossible to furnish a common definition of the term "public offer" and all its constituent parts'. In reality, whether or not a proposed issue will constitute an offer to the public and therefore require a prospectus is a matter which can only be decided on the facts and on a case-by-case basis. More often than not, what is proposed will constitute an offer to the public and will require the publication of a prospectus.

Mutual Recognition of Prospectuses

The Prospectus Directive also introduced the principle of mutual recognition of prospectuses between member states into Irish law. Where, for the same transferable securities, public offers are made simultaneously or within a short interval of one another in two or more member states and where a prospectus is drawn up in accordance with articles 7, 8, or 12 of the Prospectus Directive, the competent authority for approval of the prospectus will be that of the member state where the issuer has its registered office, if the public offering or application for admission to official listing is made in that member state.[33]

On 29 April 2004, the European Commission adopted a Regulation implementing a new Prospectus Directive (2003/71/EC), which has the aim of harmonizing further the

29 Companies Act 1963, s 46.
30 Companies Act 1963, s 44(4).
31 Companies Act 1963, s 61, as amended by Companies Act 1990, s 238.
32 Companies Act 1963, s 61(2).
33 Prospectus Directive, art 20(1).

disclosure requirements of member states of the European Union (EU). The Regulation seeks to create an effective 'single passport' for both EU and non-EU issuers; however, the Regulation sets out different minimum disclosure requirements for different types of offering. The Regulation is due to take effect from 1 July 2005.

If the member state concerned does not provide for prior scrutiny of prospectuses, a supervisory authority from those member states in which the public offer is to be made and which provides for the prior scrutiny of prospectuses must be chosen by the person making the public offer.[34]

Article 21 of the Prospectus Directive provides that, if a prospectus is approved under its provisions,[35] subject only to translation and the inclusion of information which may be specific to the market of the country where the public offer is made (in particular, the income tax system, the financial organizations retained to act as paying agents for the issuer in that country, and the way in which notices to investors are published), it must be recognized as complying or be deemed to comply with the laws of the member states in which the same transferable securities are offered to the public simultaneously or within a short interval of one another, without being subject to any form of approval there and without those member states being able to require that additional information be included in the prospectus.

The Third Schedule of the Regulations provides that, where a prospectus approved by a competent authority in another member state, pursuant to article 20 of the Prospectus Directive, is to be recognized in Ireland, there shall be added to the information contained in a prospectus approved in another member state:

- A summary of the tax treatment of Irish-resident holders of the securities;
- The names and addresses of the paying agents for the securities in Ireland (if any); and
- A statement of how notice of meetings and other notices from the issuer of the securities will be given to Irish resident holders of the securities.

If a foreign company requires to have its prospectus recognized in Ireland, the rules of the Irish Stock Exchange require that the approved prospectus be submitted to it for inspection at least 10 days prior to the intended publication date,[36] together with evidence that the competent authority approval has been granted by another member state.[37]

Provided that the Irish Stock Exchange is satisfied that the foregoing requirements have been met, it will issue written confirmation of such, following which the foreign company, subject to compliance with registration and publication requirements which will be dealt with below, can proceed to publish the prospectus in Ireland.

34 Prospectus Directive, art 20(2).
35 Prospectus Directive, art 20.
36 Prospectus Directive, art 21(3); Purple Book, para 17.73.
37 Purple Book, para 17.73A.

Part XII of the Companies Act 1963 deals with the prospectus requirements for foreign incorporated companies.[38] However, the requirements are similar to Part III of the Companies Act 1963 in many respects. Part XII provides that it is not lawful for any person to distribute a prospectus in Ireland offering for subscription shares in or debentures of a company incorporated outside Ireland unless it contains the information required by Part III of the Companies Act 1963.[39]

Section 361(4) of the Companies Act 1963 provides that it is not lawful for any person to issue to any person in Ireland a form of application for shares or debenture in a company incorporated outside Ireland, unless the form of application complies with Part XII and the Third Schedule of the Companies Act 1963.

It should be noted that an exception to the foregoing prohibitions is allowed in the case of a prospectus or a form of application, as the case may be, issued and complying with the law of a 'recognized country' for this purpose. By virtue of the Companies (Recognition of Countries) Order 1964,[40] only the United Kingdom has been designated a 'recognized country' for these purposes. However, having regard to regulation 21(3) of the Regulations, should a company incorporated outside Ireland issue a form of application accompanied by a prospectus approved under the Prospectus Directive, it need not have attached to it a form of application required by section 361(4).

Issuer Requirements

As outlined, a prospectus must contain certain information as stipulated by Irish law and according to the rules of the Yellow Book. Generally, an issuer must ensure that any prospectus contains such information which is necessary to enable investors and their advisers to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer, and the rights attaching to the securities.[41]

In Ireland, this responsibility for the most part falls on the directors, who have overall responsibility for the contents of the prospectus. Directors, and any proposed director, must expressly accept responsibility for the prospectus contents by virtue of the responsibility statement required under the Yellow Book.

The information contained in a prospectus must be in accordance with the facts and may not omit anything likely to effect the import of such information. One must always be aware that an omission of material information could result in a breach of duty on the part of those responsible for the issue of the prospectus, and could give rise to an action for damages against the issuers.

38 Companies Act 1963, s 361(1)(a) and (b).
39 Companies Act 1963, s 361(1)(a) and (b).
40 Companies (Recognition of Countries) Order 1964, SI Number 42 of 1964.
41 Listing Particulars Directive, art 4(1).

Securities Requirements

No form of application for shares or debentures in a company can be issued to the public or any section of the public in Ireland unless the form is issued with a prospectus compliant with the Regulations. Private companies in Ireland are prohibited from offering shares to the public.[42] A company incorporated in Ireland can only allot shares if it is authorised to do so by an ordinary resolution or under the terms of the company's articles of association.

Irish company law provides for a statutory right of pre-emption.[43] Unless such pre-emption rights are disapplied or modified in their application, where a company offers shares for cash, it must first offer the new shares to existing members in proportion to their existing holdings. Pre-emption rights do not apply where shares are wholly or partly paid-up otherwise than in cash.[44]

Where a public limited company incorporated in Ireland proposes to allot shares fully or partly paid-up otherwise than for cash, an expert's report on the value of the non-cash consideration must be obtained prior to any allotment of such shares.[45]

If it is proposed to list the securities on the Irish Stock Exchange, the securities must conform with the law of the applicant's place of incorporation, be duly authorised according to the applicant's memorandum and articles of association, and have any necessary statutory or other consents.[46] The securities also must be freely transferable and, if the applicant is a company incorporated in Ireland, it may not be a private company or an 'old public company'.[47] The Irish Stock Exchange also may make the admission of securities to listing subject to any special condition which it considers appropriate in the interests of protecting investors.[48]

Except in the case of public limited companies, at least five per cent of the nominal value of a share must be paid on application;[49] an Irish public limited company cannot allot shares unless at least 25 per cent of the nominal value of the share and the whole of any premium on it is paid.[50]

No allotment of share capital of a company offered to the public for subscription may be made unless the amount stated in the prospectus as the minimum amount which in the directors' opinion must be raised to provide for the matters specified in paragraph 4 of the Third Schedule to the Companies Act has been subscribed.[51] The company has 40 days

42 Companies Act 1963, s 33(1)(c).
43 Companies (Amendment) Act 1983, Act Number 13 of 1983, s 23.
44 Companies (Amendment) Act 1983, s 24.
45 Companies (Amendment) Act 1983, s 30.
46 Purple Book, para 3.14.
47 Companies (Amendment) Act 1983, s 12; Purple Book, para 3.2, as amended by the Notes on Listing Rules, 3 December 1999.
48 Purple Book, para 3.1.
49 Companies Act 1963, s 53(3).
50 Companies (Amendment) Act 1983, s 28.
51 Companies Act 1963, s 53(1).

after the first issue of the prospectus within which to comply with this condition, following which all money received must be repaid to applicants without interest.

If the monies are not repaid within 48 days after the issue of the prospectus, the directors of the company will be jointly and severally liable to repay that money with interest at the rate of five per cent *per annum*.[52]

Where a prospectus is issued generally to the public, an allotment of any shares and proceedings may not be taken on applications made in pursuance of such a prospectus so issued until the beginning of the fourth day after that on which the prospectus is first issued as a newspaper advertisement or, if it is not so advertised, the day on which it is first issued in any manner.[53]

If a prospectus states that an application has been or will be made for permission for the shares offered thereby to be dealt in on any stock exchange, any allotment made pursuant to the prospectus will be void if the permission has not been applied for before the third day after the first issue of the prospectus or if the permission has not been granted within six weeks of the closing of the subscription lists.

Where permission has not been applied for, or has not been granted, all money received must be repaid to applicants without interest. If the money is not repaid within eight days after the company becomes liable to repay it, the directors of the company will be jointly and severally liable to repay the money with interest at the rate of five per cent per annum.[54]

When a company incorporated in Ireland allots shares, the company must deliver to the Registrar of Companies a return of the allotments within one month.[55] A company's capital duty[56] also is payable on the total amount paid to the company on allotment.

Prospectus Requirements

As mentioned above, it is unlawful to issue any form of application for securities of a company in Ireland, unless the form is issued with a prospectus which complies with the Regulations, which is to be construed as one with the Companies Act and which does not contravene section 46 of the Companies Act 1963.

If shares are being offered to the public by a company where the European Communities (Stock Exchange) Regulations 1984[57] do not apply, ie, a full stock market listing is not being sought by the company, then the company is required to issue a prospectus in

52 Companies Act 1963, s 53(4). The amount should cover the cost of the property to be acquired, expenses, commission, and working capital.
53 Companies Act 1963, s 56.
54 Companies Act 1963, s 57.
55 Companies Act 1963, s 58.
56 Companies capital duty is one per cent of the total amount paid, as of September 2004.
57 The European Communities (Stock Exchange) Regulations 1984 (SI Number 202 of 1984) implemented the Admissions Directive, the Listing Particulars Directive, and the Interim Reports Directive.

accordance with the provisions of the Companies Act itself rather than the Companies Act so amended by the Regulations.

This situation might arise where a company sought access to the Developing Companies Market or, depending on its activities, the Exploration Securities Market. If a company requires admission to the Exploration Securities Market, the Exploration Securities Market Rules would have to be considered. Rule 3.1 states that the making of public offers of securities in Ireland is subject to the Regulations which set out the legal requirements relating to prospectuses to be published in conjunction with such public offers. The obligations under the Regulations constitute separate and additional requirements to those contained in the Exploration Securities Market Rules (in particular, chapter 3).

A 'prospectus' is defined as any prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures in a company.[58] Where a prospectus is published in conjunction with an offer for subscription or purchase of securities in compliance with the Prospectus Directive's requirements, it will be deemed to be a prospectus within the meaning of the Companies Act.[59]

While it is true that the form and content of prospectuses required by the Prospectus Directive overshadow the Companies Act's requirements on prospectuses, the requirements of the Companies Act still must be considered. The Regulations provide that a prospectus must contain the information required under the Companies Act where any such information is not required by the Prospectus Directive itself.[60]

Regulation 8 of the Regulations sets out the contents required for a prospectus and states that the prospectus must contain the information necessary to allow an informed assessment to be made of the financial position and prospects of the company and the rights attaching to the securities. In addition, the prospectus should, at least, subject to certain exceptions,[61] contain details[62] as to:

- Those responsible for the prospectus;
- The offer to the public and the transferable securities being offered (including the nature of the securities; the amount and purpose of the issue; the number and rights attaching to them; any tax withheld at source; the period the offer is to be open, and the date on which entitlement to dividends or interest arises; the persons (if any) underwriting, guaranteeing the offer; restrictions on transferability; the markets in which the securities can be traded; the paying agents; if known, the price at which the securities are offered; methods of payment; and procedures for the exercise of rights of pre-emption);

58 Companies Act 1963, s 2(1).
59 Stock Exchange Regulations, reg 21(4).
60 Stock Exchange Regulations, reg 8.
61 Stock Exchange Regulations, reg 8(4). Where, having regard to the proposal as to size and circumstance of the issue of the securities, compliance with the requirements of the Third Schedule would be unduly burdensome, the Irish Stock Exchange may allow some information to be omitted from the prospectus.
62 For a more detailed account of the information required and when it is required, see articles 11.2–11.6 of the Prospectus Directive.

- The issuer (including name, date of incorporation, legislation applicable, objects, and capital);
- The issuer's principal activities;
- The issuer's assets and liabilities, and details of the issuer's financial position; profits and losses (own accounts and, where appropriate, consolidated accounts), and interim accounts, if any, since the previous financial period end;
- The issuer's administration, management, and supervision; and
- Recent developments and prospects to the extent that these would have an impact on any assessment that might be made of the issuer.

Where a public offer relates to debt securities guaranteed by one or more legal persons, the information specified at items three to seven, above, also must be given in respect of the guarantor(s) and, in addition, in the case of convertible debt securities, exchangeable debt securities, or debt securities with warrants or to the warrants themselves, the information also must be given with regard to the nature of the shares or debt securities to which they confer entitlement and the procedure of any conditions for conversion, exchange, or subscription.

If the issuer of the shares or debt securities is not the issuer of the exchangeable debt securities or warrants, the information specified at items three to seven, above, also must be given in respect of the issuer of the shares or debt securities.

So far as not already required by the Regulations, the information required under the Third Schedule of the Companies Act also must be included. It also should be pointed out that, where an issuer applies for listing of the securities on the Irish Stock Exchange, listing particulars will have to be published pursuant to the Listing Particulars Directive and the Yellow Book.

Where listing particulars have been approved by the Irish Stock Exchange, the form of application need not have a prospectus in the form required by the Third Schedule to the Act attached to it.[63] This is, of course, also subject to the principle of mutual recognition.[64]

As a result of vague drafting and the resulting conflict between the application of the Listing Particulars Directive and the Prospectus Directive in cases where securities are being offered to the public for the first time, many Irish lawyers adopt a cautious approach by requiring the listing particulars to comply with the requirements of the Prospectus Directive, in addition to the requirements of the Listing Particulars Directive and the Purple Book. Practically, the task is simplified as the contents requirements under the Prospectus Directive and the Listing Particulars Directive are similar.

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63 Stock Exchange Regulations, reg 12(2), SI Number 282 of 1984.

64 Listing Particulars Directive (as amended), art 24, provides that where application for admission to official listing is made in one member state and the securities the subject of the application have been the subject of a public offer prospectus approved under the Prospectus Directive within the preceding three months preceding the application for admission, the public offer prospectus will be recognised as the listing particulars in the member states where the application for listing is made.

Supplementary listing particulars must contain the details required by paragraph 5.16 of the Purple Book, and they are required in the following circumstances:

- If, at any time after the listing particulars have been approved by the Irish Stock Exchange and before dealings in the relevant securities commence, there has been a significant change affecting any matter contained in the particulars; and
- A matter has arisen which would have required mention in the listing particulars had it arisen at the time of their preparation.[65]

Corporate Governance

One of the primary responsibilities of the Irish Stock Exchange is regulation and supervision of the manner in which companies whose securities are authorised to trade on any of its markets fulfil obligations to make full disclosure of relevant information to the market. When the Irish Stock Exchange separated from the London Stock Exchange, the Irish Stock Exchange set about maintaining standards of corporate governance equivalent to those of the London Exchange.[66]

Section 1 of the Combined Code deals with corporate governance principles; Part A addresses provisions relating to the board of directors, the chairman and chief executive officer, board balance, supply of information, appointments to the board, and re-election, and Part B deals with directors' remuneration.

The Combined Code has been extensively revised to take account of the recommendations contained in the report produced by Sir Derek Higgs (the 'Higgs Report'). The Combined Code is applicable for reporting periods commencing on or after 1 November 2003. The recommendations in the Higgs Report extended to such areas as:

- The structure and balance of the board of directors;
- The role of the chairman;
- The role and liability of non-executive directors;
- The role, duties, and authority of the nominations committee;
- The attendance at and frequency of nominations committee meetings;
- The role of audit and remuneration committees;
- The appointment and re-election of directors; and
- The relations between shareholders.

The Purple Book requires a company incorporated in Ireland to include a statement in its annual report and accounts detailing how it has applied the principles set out in section 1 of the Combined Code. It also requires that an explanation be provided which enables its shareholders to evaluate how the principles have been applied and a statement as to whether or not it has complied with section 1 of the Combined Code throughout the accounting period. If a company has not complied with all the Combined Code

65 Purple Book, para 5.14.

66 The Combined Code, ie, the Principles of Good Governance and Code of Best Practice appended to but not forming part of the Purple Book.

provisions, it must specify which provisions it has not complied with, the period of non-compliance, and reasons for non-compliance.[67]

Rule 12.43A(c) of the Purple Book requires disclosure of the amount of each element of the remuneration package, including pension entitlements and the disclosure of individual directors' remuneration by name. Parts C and D of the Combined Code contain provisions relating to relations with shareholders and accountability and audit, respectively.

Clearly, the intention behind rule 12.43A is that companies listed on the Irish Stock Exchange should account for their governance and explain any departure from the principles set out in the Combined Code. However, as stated in the preamble to the Combined Code, it is for the shareholders themselves to evaluate the company's report on its application of the principles of the Combined Code. Interestingly, it also should be noted that Part 2 of the Combined Code includes governance principles for institutional shareholders relating to voting, dialogue with companies, and evaluation of governance disclosures.

Registration of Public Offerings and Placements

The Regulations provide that every prospectus issued under the Regulations shall be registered with the Registrar of Companies in Ireland in compliance with section 47 of the Companies Act.[68] Before registration with the Registrar of Companies, the prospectus must first have been submitted to the Irish Stock Exchange as the designated body for the purposes of the Prospectus Directive.[69]

Section 47 provides that no prospectus may be issued unless on or before the date of its publication there has been delivered to the Registrar of Companies a copy thereof signed by every person named in it as a director or a proposed director of the company, or by his agent authorised in writing, ie, signed by his lawful attorney.

Where admission to Official Stock Exchange listing is not being sought, the prospectus must be made available to the public by notice in one or more daily newspapers in Ireland and in the form of a brochure to be made available free of charge at the registered office of the issuer and at the offices of the financial organization retained to act as paying agent.[70]

Every prospectus must, on its face, state that a copy has been delivered for registration as required by section 47 of the Act.[71] Documents which must be delivered to the Registrar of Companies in addition to the prospectus are:

- Consent of any expert required by section 46 of the Act;
- Copies of any material contract; and

67 Purple Book, rule 12.43A(a) and (b).
68 Stock Exchange Regulations, reg 11.
69 Regulation 9(1) of the Stock Exchange Regulations designates the Irish Stock Exchange for the purposes of articles 11.7, 11.8, 13.1, 13.2, and 19 of the Prospectus Directive as the body which may authorise the omission or exemption of the information specified in the respective articles.
70 Stock Exchange Regulations, reg 12.
71 Companies Act 1963, s 47(2).

- If any adjustments have been made to the accounts by the auditors, a written statement setting out the adjustments and giving reasons therefore.[72]

Where admission to the Official Stock Exchange listing is sought, the prospectus must be prepared in accordance with Listing Particulars Directive[73] standards. By virtue of regulation 19 of the Regulations, the Irish Stock Exchange is designated as the competent authority for scrutinising the contents of a prospectus for these purposes. The rules of the Yellow Book relating to contents and timing also must be considered.

Periodic Disclosure

General Obligation under the Listing Rules

The Listing Rules set down a general obligation for overseas companies to notify the Company Announcements Office of the Irish Stock Exchange, without delay, of major new developments in their sphere of activity which are not public knowledge and which may, by virtue of the effect of those developments on their assets and liabilities or financial position or in the general course of their business, lead to substantial movement in the price of their listed securities or, where the companies have debt securities listed, significantly affect their ability to meet their commitments.[74]

In particular, a company is obliged to notify the Company Announcements Office without delay of all relevant information which is not public knowledge concerning a change and which, if made public, would be likely to cause substantial movements in the company's share price, including:

- The company's financial condition;
- The performance of its business; and
- The company's expectation as to its performance.[75]

All information notified to the Company Announcements Office must be in the English language. Obviously, a company must take all reasonable care to ensure that the information provided to the Company Announcements Office is accurate and not misleading and does not omit anything which would affect the import of the statement.

There is no obligation to notify information about impending developments or matters in the course of negotiation. Companies are, of practical necessity, allowed to furnish such information to their advisers, persons with whom the companies are negotiating, employee representatives, and any regulatory body or authority.[76]

72 Companies Act 1963, s 47(1)(a) and (b).
73 Article 7 of the Prospectus Directive.
74 Purple Book, paras 9.1 and 17.22.
75 Purple Book, paras 9.2 and 17.23.
76 Purple Book, paras 9.5, 17.25, and 17.26.

Where a company does divulge this information, it should satisfy itself that recipients of information are aware of their obligations regarding confidentiality and that they do not deal in securities before the information in question has been made available to the public.[77]

If, however, the company believes that a breach of confidence has occurred or is likely to occur, then it must without delay forward to the Company Announcements Office at least a warning announcement to the effect that the company expects shortly to release information which may lead to a price movement.

With the exception of the preceding cases, companies must ensure that relevant information is not given to anyone else before it has been notified to the Company Announcements Office, unless the Company Announcements Office is not open for business, in which case publication via the newspaper and electronics media is necessary.[78]

It also should be noted that, if any information which could lead to substantial movement in share price is to be announced at a meeting of shareholders, it must be notified to the Company Announcements Office so that the announcement at the meeting is made no earlier than publication to the market.[79] Notwithstanding the above, it is still possible for a company to safeguard against its legitimate interests being prejudiced by requesting the Exchange to grant a dispensation from the disclosure requirement in this regard. A company must forward to the Company Announcements Office six copies of:

- All circulars, notices, reports, announcements, or other documents at the same time as they are issued; and
- All resolutions passed by the company other than resolutions concerning ordinary business at an annual general meeting, without delay after the relevant general meeting.

Specific Notifications

Apart from the general obligations of disclosure set out above, there are specific notification requirements regarding changes in capital structure and major interests in shares.

Notifications as to Capital

A company must furnish the following to the Company Announcements Office without delay:

- Any proposed change in its capital structure;
- Any new issues of debt securities and, in particular, any guarantee or security in respect thereof;

77 Purple Book, paras 9.5 and 17.26.

78 Purple Book, paras 9.15 and 17.67. Where the Company Announcements Office is not open, information must be distributed to not less than two national newspapers in Ireland and to two newswire services operating in Ireland. The Company Announcements Office must be notified as soon as it re-opens.

79 Purple Book, paras 9.7 and 17.28.

- Any change in the rights attaching to any class of listed securities or to any securities into which any listed securities are convertible;
- Any drawing or redemption of listed securities (other than purchases to meet sinking fund requirements of the current year) both before and after any such drawing;
- The basis of allotment of listed securities offered generally to the public for cash and of open offers to shareholders;
- Any extension of time granted for currency of temporary documents of title;
- The effect (if any) of any issue of further securities on conversion rights; and
- The results of any new issue of listed securities.[80]

Notifications of Interests in Shares

Overseas Company with Primary Listing on Irish Stock Exchange

Sections 67–79 of the Companies Act 1990[81] require a person or, in some cases, a group of persons[82] to notify an Irish registered public limited company when he becomes interested in five per cent or more of the nominal value of the issued share capital of the company in question. In addition, where the interest of a major shareholder[83] is reduced or increased or ceases to exist, this also must be notified by the shareholder to the company and then by the company to the Company Announcements Office by the end of the next day following receipt of such notification.

Overseas companies must notify the Company Announcements Office without delay of any information equivalent to this required under the law of their country of incorporation or the member state[84] where they have their primary listing. The notification must include the date on which the information was disclosed to the company and the date on which the transaction in question was effected, if known.[85]

Notifications regarding major interests in shares are deemed to have been discharged if the interest is notified to the Company Announcements Office pursuant to the disclosure provisions of the City Code on Take-overs and Mergers or the Rules governing Substantial Acquisitions of Shares issued by the Panel on Take-overs and Mergers.[86]

Section 81 of the Companies Act 1990 allows a public limited company to request information from a registered shareholder regarding his past or present interest in shares in the

80 Purple Book, para 9.10; if the securities are subject to an underwriting agreement, the company may delay notifying the Company Announcements Office until the underwriters' obligations have been satisfied or lapse. This only applies to an overseas company with a primary listing on the Irish Stock Exchange.
81 Companies Act 1990, Act Number 33 of 1990.
82 See the Companies Act 1990, s 73, regarding an agreement between two or more persons to acquire interests in a public limited company.
83 A person holding five per cent or more of the nominal value of the issued share capital.
84 A state which has ratified the agreement on the European Economic Area.
85 Purple Book, para 9.11.
86 While the Irish Listing Rules do not refer to the Irish Take-over Panel Act 1997 (Take-over) Rules and Substantial Acquisition Rules, presumably this also should be the case.

company and the identity of persons interested in the shares in question. The information which an overseas company receives in response to a similar request also must be communicated to the Company Announcements Office within the time frame outlined above.

Overseas Company with Secondary Listing on Irish Stock Exchange

An overseas company with a secondary listing on the Irish Stock Exchange must notify the Company Announcements Office of the following:

- If incorporated in a member state, the company must notify details of the interests of which the company is aware in the shares of the company of directors and major shareholders as communicated to the company pursuant to the law of the company's country of incorporation and (if different) the requirements of the competent authority of the member state where the company has its primary listing;
- If incorporated in a non-member state, the company must notify the following details when it becomes aware that a person or entity has acquired or disposed of a number of shares such that that person's or entity's holding of the voting rights in the company reaches, exceeds, or falls below 10 per cent, 20 per cent, one-third, 50 per cent, or two-thirds of the total voting rights: (a) the proportion of voting rights held, (b) the identity of the person or entity, and (c) the date on which the company becomes so aware; and
- The notification must be made within nine calendar days of the date on which the company becomes aware of the acquisition or disposal.[87]

Communication with Shareholders

There is an overriding obligation on a listed company to ensure that holders of listed shares who are in the same position are treated equally. This is reflected in the procedural requirements for communication of information to shareholders. A company must ensure that, at least in each member state in which its securities are listed, all of the necessary facilities and information are available to enable its shareholders to exercise their rights.

It must inform shareholders when meetings which they are entitled to attend will be held. The company must enable shareholders to exercise the right to vote, where applicable, and must publish notices or distribute circulars giving information on the allocation and payment of dividends and interest, the issue of new securities, and the redemption or repayment of securities.[88] A proxy form must be sent with the notice convening a meeting of shareholders to each person who is entitled to vote at the meeting.[89] The proxy form itself must comply with the requirements of Listing Rules.[90]

87 Purple Book, para 17.33. Voting rights that are regarded as held by a person or entity are determined in accordance with the Major Shareholding Directive.
88 Purple Book, paras 9.24 and 17.40.
89 Purple Book, paras 9.26 and 17.14.
90 Purple Book, paras 13.28 and 13.29.

Where a circular is issued to holders of a particular class of security, a copy or summary of that circular also must be issued to holders of other classes, unless the contents are actually irrelevant to them.[91] If it is necessary to communicate with holders of listed bearer securities, the company must place an advertisement in at least one national newspaper, giving an address from which copies of such communication can be obtained.

Where available, first class mail, or an equivalent service which is no slower, must be used when sending documents of title to holders of listed securities in Ireland and other member states. Where available, airmail, or an equivalent service which is no slower, must be used when sending documents to holders of listed securities residing in non-member states. If, however, the overseas company is not incorporated in a member state, it must use airmail, or an equivalent service which is no slower, when sending documents to holders outside its country of incorporation.[92]

Annual Report and Accounts

Overseas Company with Primary Listing on Irish Stock Exchange

Apart from any obligations under the law of a company's country of incorporation, a listed company is obliged to issue an annual report and accounts.[93] The annual report and accounts must:

- Have been prepared in accordance with the issuer's national law and, in all material respects, with Irish Generally Accepted Accounting Principles, United States Generally Accepted Accounting Principles, or International Accounting Standards;
- Have been independently audited and reported on in accordance with the auditing standards required in Ireland or the United States or by International Standards on Auditing;
- Be in consolidated form if the company has subsidiary undertakings unless the Irish Stock Exchange otherwise agrees, although the company's own accounts also must be published if they contain significant additional information;
- If they do not give a true and fair view of the state of affairs, profit or loss, and cash flows of the group, provide more detailed and additional information; and
- Be published as soon as possible after the accounts have been approved and in any event within six months of the end of the financial period to which they relate.[94]

The annual report and accounts must contain:

- A commentary on forecasts;
- A statement of the amount of interest capitalized;
- Details of any waiver of emoluments;

91 Purple Book, paras 9.27 and 17.42.
92 Yellow Book, para 17.43.
93 Yellow Book, para 12.41.
94 The Irish Stock Exchange will extend this time limit in exceptional circumstances.

- Details of any waiver of dividends;
- A statement of directors' share interests;
- Major interests in shares;
- Details of purchases by a company of its own shares;
- Allotments for cash;
- Details of the participation by a parent undertaking in any placing made during the period under review;
- Details of any contract of significance and of any such contracts in which a director of the company is or was materially interested;
- Details of any contract of significance between a company or one of its subsidiary undertakings and a controlling shareholder;
- Details of any contract for the provision of service to the company or any of its subsidiaries by a controlling shareholder;
- Details of all related party transactions; and
- Details of long-term incentive schemes.[95]

Overseas Company with Secondary Listing on Irish Stock Exchange

An annual report and accounts also must be issued by an overseas company with its secondary listing on the Irish Stock Exchange. The annual report and accounts must be:

- Drawn up and independently audited in accordance with the requirements of paragraphs 3.3(c), 3.3(d), 3.4, and 3.5 of the Purple Book;[96]
- In consolidated form if the company has subsidiary undertakings;[97]
- Published within six months of the end of the financial period to which they relate; and
- Provide more detailed and additional information if they do not give a true and fair view of the state of affairs in profit or loss of the group.[98]

The annual report and accounts must be prepared to a standard appropriate to protect the interests of investors and must include:

- Particulars of the interest in its equity share capital of each director and major shareholder as required by the company's country of incorporation; and

95 Purple Book, para 12.43.
96 If the Exchange is satisfied that an overseas company's accounts have been prepared to a standard appropriate to protect the interests of investors, different standards from those referred to in paragraph 3.3(c) may be accepted in an accountant's report, comparative table, and in the annual report and accounts. The accounts must then comply with paragraph 17.3.
97 The company accounts also must be published if they contain significant additional information.
98 Purple Book, para 17.45.

- The information necessary to enable holders of its listed securities resident in Ireland to obtain any relief from Irish taxation to which they are entitled in respect of their holding of such securities.

The report of the auditor must be annexed to all copies of the annual accounts and indicate whether in his opinion the accounts give a true and fair view, in the case of the company's accounts, of the state of its affairs at the end of the financial year and the profit and loss and changes in the financial position for the financial year and, where consolidated accounts are prepared, of the state of affairs at the end of the financial year and profit and loss and changes in the financial position of the company and its subsidiary undertakings for the financial year.[99]

However, such an auditor's report is not required if the report conforms to auditing practice in the United States. In addition, where a company is incorporated in a non-member state and is not required to draw up its accounts so as to give a true and fair view, it must consult the Irish Stock Exchange to establish whether the standard to which they are drawn up will be sufficient.[100]

An overseas company must circulate, to all holders of its listed securities whose addresses are in Ireland, a copy of the annual report and accounts together with a copy of the auditor's report. If any listed securities are in bearer/quasi-bearer form, the company must place an advertisement in two national newspapers published in Ireland stating the time and place in or near the center of the city of Dublin, or such other place as the Exchange may determine, from which copies of such report and accounts and auditor's report may be obtained without charge.

Half-Yearly Report

An overseas company must prepare a report, on a group basis where relevant, on its activities and profit and loss for the first six months of each financial year.[101] The accounting policies and presentation applied to these interim figures must be consistent with those applied in the latest published annual accounts, save where there are to be changes in the subsequent annual financial statements or where the Irish Stock Exchange agrees otherwise.[102]

The half-yearly report must be published as soon as possible and in any event within 90 days of the end of the period to which it relates in the case of an overseas company with a primary listing on the Irish Stock Exchange. In the case of an overseas company with a

99 Purple Book, para 17.47.
100 Purple Book, para 17.49.
101 Purple Book, paras 12.46 and 17.52.
102 Purple Book, para 12.47, applicable to an overseas company with a primary listing on the Irish Stock Exchange only. Where the company has a secondary listing of the Irish Stock Exchange and its half-yearly report is not prepared on a basis consistent with its annual accounts, the half-yearly report must include a statement that, in the directors' opinion, the half-yearly report enables investors to make an informed assessment of the results and activities of the group for the period.

secondary listing on the Irish Stock Exchange, the report must be published within four months of the end of that period to which it relates. Again, this may be extended by the Irish Stock Exchange in exceptional circumstances.

The report must be published by notifying it to the Company Announcements Office without delay after board approval and simultaneously to the competent authorities of each other member state in which the company's shares are listed, not later than the time the report is first published in a member state. In addition, the company must either send the half-yearly report to the holders of its listed securities or insert it, as a paid advertisement, in at least one national newspaper.

In the case of a company with a secondary listing, it must make copies of the report available to the public at an address in Ireland and advertise this fact in at least one Irish national newspaper. The information required by paragraphs 12.52–12.59 of the Listing Rules, in the case of a company with primary listing, or paragraphs 17.58–17.63, in the case of a company with a secondary listing, must be included in the report in respect of the group's activities and profit or loss during the relevant period.[103]

In exceptional circumstances, if Ireland is the only member state in which the company is listed, the Irish Stock Exchange may allow the report to include estimated figures for profit and loss. In such a case, a statement to the effect that the figures are estimates must be included.[104] The half-yearly report must contain:

- An explanatory statement including any significant information enabling investors to make an informed assessment of the trend of the group's activities and profit or loss;
- An indication of any special factor which has influenced those activities and the profit or loss during the period in question;
- Enough information to enable a comparison to be made with the corresponding period of the preceding financial year; and
- A reference to the group's prospects in the current financial year, so far as possible.

Certain information may be adapted or omitted, at the discretion of the Irish Stock Exchange, to suit the company's particular requirements.[105]

Where a company is incorporated in a non-member state and publishes a half-yearly report in that country, the Irish Stock Exchange may authorize it to publish that report, translated into English if necessary, instead of the half-yearly report referred to above, provided that the information given is equivalent to that which would have been otherwise required.[106]

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103 Purple Book, paras 12.51 and 17.57.

104 Purple Book, para 12.55.

105 Purple Book, paras 12.57, 12.58, 12.59, 17.61, and 17.62. The figures required by paragraph 17.58 (a), (b), (d), and (e) and paragraph 17.61 in relation to a secondary listed company may be omitted if disclosure would be contrary to the public interest or seriously detrimental to the company, provided in the case of the latter that the public would not be misled regarding facts and circumstances required to assess the shares in question. A request for omission must be in writing.

106 Purple Book, para 17.7.

Directors

An overseas company must notify the Company Announcements Office of any change to the board without delay following the decision or receipt of notice about the change by the company, including:

- The appointment of a new director;
- The resignation, removal, or retirement of a director; and
- Changes to any important functions or executive responsibilities of a director.

Acquisitions and Disposals

An overseas company with a primary listing on the Irish Stock Exchange must comply with chapter 10 of the Yellow Book dealing with transactions and, where applicable, chapter 11 dealing with transactions with related parties. An overseas company with a secondary listing must notify the Company Announcements Office of details of acquisitions and disposals of assets as required by the stock exchange on which the company has its primary listing.[107]

However, where the transaction in question can be classified as a reverse take-over,[108] the Irish Stock Exchange must be consulted regarding the information to be provided to shareholders.[109]

Shares in Public Hands

An overseas company must inform the Irish Stock Exchange in writing without delay if it becomes aware that the proportion of any class of listed equity shares in public hands has fallen below 25 per cent of the total issued share capital of that class or such lower percentage as the Exchange may have agreed.[110]

Proxy Forms

A proxy form must be sent with the notice convening a meeting of holders of securities to each person who is entitled to vote at the meeting. The form must provide for two-way voting on all resolutions, except for procedural resolutions, and state that the shareholder is entitled to appoint a proxy of his own choice and provide a space for insertion of the name of such proxy.

This restricts the company from allowing shareholders only to appoint the chairman of the company as their proxy, for example. The form also must state that if it is returned without

107 Purple Book, para 17.32.
108 A take-over where the target is larger than the bidder so that the result of the take-over is that the target shareholders become majority shareholders in the bidder.
109 Purple Book, para 10.1(f).
110 Purple Book, para 17.6.

an indication as to how the proxy shall vote on a particular matter, the proxy will exercise his discretion as to whether, and if so how, he votes.[111]

Where the resolutions to be proposed relate to the re-election of more than five retiring directors, the form may give shareholders the opportunity to vote for or against the re-election of the retiring directors as a whole but also must allow votes to be cast for or against the re-election of each retiring director individually.[112]

Developing Companies Market

General Obligation of Disclosure

A company whose securities are admitted to trading on the Developing Companies Market must notify the Company Announcements Office without delay of any major new developments in its sphere of activity which are not public knowledge and which may lead to substantial movement in its share price as a result of the effect of those developments on its assets or liabilities, or financial position or general course of its business.

The Developing Companies Market Rules, however, specifically refer to the directors' knowledge of developments. Where the directors are aware that there is such a change in the company's financial position or performance, or in the company's expectation of its performance, and that knowledge is likely to lead to substantial movement in share price, the notification obligation arises.

Impending developments or matters currently under negotiation do not necessitate notification provided they are proceeding in a strictly confidential basis. If the company suspects a breach of this confidence has occurred, or is likely to occur, which would lead to substantial movement in share price, the company must, without delay, notify the Company Announcements Office with at least a warning announcement to the effect that the company expects to shortly release information which may lead to such movement. Information which has been provided by a company in confidence to government departments or other statutory or regulatory bodies need not be notified to the Company Announcements Office.

Information required by the Company Announcements Office may not be given to anyone else, other than the company's advisers on a strictly confidential basis, before it is notified to the Company Announcements Office except in the circumstances mentioned above.

Where disclosure to the public would prejudice the company's legitimate interests, the Irish Stock Exchange may grant a dispensation from the relevant requirements. A company whose securities are also quoted on another stock exchange must ensure that equivalent information is made available at the same time to the Company Announcements Office and the market of each such other exchange.

Where the company is obliged to notify information to the Company Announcements Office when the office is not open for business, it must ensure there is adequate coverage

111 Purple Book, para 13.28.
112 Purple Book, para 13.29.

of the information by distributing it to not less than two national daily newspapers in Ireland. The company must lodge the announcement at the Company Announcements Office when it re-opens.

The company must forward six copies of all circulars, notices, reports, announcements, or other documents to the Company Announcements Office at the time of their issue and all resolutions passed by the company, other than resolutions concerning ordinary business at an annual general meeting, without delay after the meeting.

Specific Disclosures

Apart from this general obligation of disclosure, there are specific disclosure requirements in the Developing Companies Market Rules relating to capital as follows:

- Alterations to capital structure;
- New issues of securities;
- Changes of rights attaching to securities;
- Redemption or drawing of quoted securities;
- The basis of allotment of quoted securities offered generally to the public for cash and of open offers to shareholders;
- Temporary documents of title and any extension granted for the currency of such documents;
- Issues affecting conversion rights; and
- Results of new issues.[113]

Where an overseas company receives information equivalent to that received by an Irish company under sections 67–79 and 81 of the Companies Act 1990, relating to the disclosure of certain major interests in share capital, it must notify it to the Company Announcements Office without delay.[114]

A company also must inform the Irish Stock Exchange in writing without delay if it becomes aware that the level of shares in public accounts has fallen below 10 per cent of the total issued share capital of that class.[115] It also must notify the Company Announcements

113 Developing Companies Market Rules, para 4.9. The company also must notify the Company Announcements Office of interests of directors (their spouses and children) and connected persons. Overseas companies must notify information equivalent to that disclosed to Irish companies in this regard pursuant to the Companies Act 1990. The notification also must include the date on which the disclosure was made to the company, the date on which the transaction giving rise to the interest or cessation of interest was effected, the price and class of securities concerned, the nature of the transaction, and the nature and extent of the directors' interests in the transaction.

114 Developing Companies Market Rules, para 4.15.

115 Developing Companies Market Rules, para 4.28.

Office of decisions by the board of directors on dividends, profits, and other matters requiring announcement by 5:30 pm on the day on which the decision is made.[116]

Board Changes

In circumstances where a new director is appointed, resigns, or is removed, or any important change in the functions or executive responsibilities of a director occurs, the company must notify the Company Announcements Office without delay.

Miscellaneous

A company must notify the Company Announcements Office without delay of the resignation of its sponsoring broker and the appointment of a new sponsor. It also is obliged to appoint a registrar and, where appropriate, a paying agent in Ireland unless it provides financial services and performs these functions within Ireland.[117]

A decision to pay a dividend or other distribution on quoted securities or to withhold any dividend or interest payment also is an event worthy of notification, and the information specified in paragraph 4.36 must be provided to the Company Announcements Office.

Communications with Shareholders

As under the Purple Book, the Developing Companies Market Rules impose an overriding obligation to treat holders of securities who are in the same position equally. It must ensure that all necessary facilities and information are available to enable holders of its securities to be aware and to exercise their rights as shareholders.[118]

To facilitate exercise of rights, a proxy form must be sent with each notice convening a shareholders' meeting to each person entitled to vote at the meeting. Where a circular is issued to holders of a particular class of security, a copy or summary of it must be issued to holders of shares of other classes unless the contents are irrelevant to them.

Financial Information

The company must notify the Company Announcements Office without delay after board approval of a preliminary statement of its annual results. This must have been agreed with the company's auditors, give details of the nature of any qualification to the auditors' report, show the figures in a form consistent with the presentation to be adopted in the annual accounts for that year, and include any significant additional information necessary to assess the results being announced.

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116 If the decision is made after 5:30 pm, the notification must be made before 8:30 a.m. on the next business day.

117 Developing Companies Market Rules, para 4.22.

118 Developing Companies Market Rules, para 4.21.

A company also must notify the Company Announcements Office without delay after board approval of its half-yearly results. This must include the figures listed in rule 4.35 presented in a table form. Adjustments may be made where the items specified are not appropriate to the company in question. The half-yearly report must be issued within four months of the end of the period to which this relates.

Annual Report and Accounts

The company must issue its annual report and accounts within six months of the end of the period to which it relates. These must be prepared in accordance in all material respects with Irish Accounting Standards or International Accounting Standards.

They must have been independently audited and reported on in accordance with the auditing standards required in Ireland, or with international standards on auditing. They must be in consolidated form if the company has subsidiaries, unless the Irish Stock Exchange otherwise agrees. If they do not give a true and fair view of the state of affairs, profit or loss cash flows of the group, they must provide more details and additional information; and they must be published as soon as possible after the accounts are proved.

Rule 4.39 specifies items that must be included in the report and accounts, unless the Irish Stock Exchange agrees otherwise. Where these items refer to specific sections of Irish legislation, overseas companies must include equivalent information as far as they are aware of it.

Exploration Securities Market

Disclosure obligations of companies listed on the Exploration Securities Market replicate those described above in relation to the Developing Companies Market except that, where a company whose securities are admitted to trading on the Exploration Securities Market fails to comply with its general obligation of disclosure, the Irish Stock Exchange may:

- Discontinue the admission of securities to trading;
- Suspend trading in the securities;
- Publish the fact that the company concerned has failed to comply with the obligations; and
- Itself make public any information which the company has failed to publish.

Technology Market of the Irish Stock Exchange — ITEQ(r)

There are two possible methods of entry to ITEQ, ie, the Official List and Direct Entry. A technology company which is officially listed may be automatically admitted to ITEQ without any additional documentation or regulatory obligations to those applying to the Official List. It will, of course, be required to continue to comply with the Official List

requirements. Companies applying for Official Listing have the following options, depending on the circumstances of the company:

A company applying for admission to the Official List must meet all of the requirements of the Listing Rules of the Exchange. In certain circumstances, the Exchange accepts that if an Irish company has the majority of its shareholders and business in another country and is subject to appropriate regulation on a stock market in that country, an Irish listing could be considered to be a secondary listing. Where this is accepted, certain exemptions from the normal listing rules and continuing obligations will be applied at the time of listing in Dublin.

The ITEQ rules are compatible with the United States Securities Exchange Commission registration process and German *Neuer Markt* admission rules. A particular feature of the rules is that they allow a company which is applying for admission to a United States market to use the Securities Exchange Commission registration statement (with certain minor additional disclosures) as the admission document for ITEQ. Direct admission to ITEQ is available for a technology company irrespective of its revenue earning record.

To improve trading liquidity, particularly for NASDAQ-quoted companies, ITEQ allows for trading in depository receipts on the Irish market. Trading in American Depository Receipts is exempt from Irish Stamp Duty.

There is no material effect of choosing one method of entry over another as far as trading in shares and the ability to raise equity capital is concerned. However, Stock Exchange documentation and the admission document of an ITEQ company will identify the regulatory regime to which it will be subject.

Trading Rules

Securities Offerings

In General

The primary list for equities listings on the Irish Stock Exchange is the Official List, and the index of listed shares is known as the ISEQ index. The admission and listing requirements for companies seeking a listing on the Irish Stock Exchange are set out in the Purple Book.

As to the secondary lists, the Developing Companies Market Exploration Securities Market and ITEQ each have separate admission rules. There are many methods of bringing securities to listing, and they are detailed in chapter 4 of the Purple Book.[119]

Offer for Sale or Offer for Subscription

An offer for sale is an invitation to the public by or on behalf of a third party to purchase securities of the issuer already in issue or allotted.[120] An offer for subscription is an

119 Cahill, *Corporate Finance Law* (2000).
120 Purple Book, para 4.4.

invitation to the public by or on behalf of a third party to subscribe for securities of the issuer not yet issued or allotted.[121]

These offers may be in the form of an invitation to tender at or above a stated minimum price. In an offer for sale, the issuer company allots the shares to an intermediary, who in turn makes the offer to the public. In this type of offer, the intermediary acts as a principal and not as agent of the company. A company may decide to offer securities by way of a combined offer for sale and offer for subscription. Such an arrangement allows existing shareholders of the company to use the occasion of listing to sell their shares to the public when listing occurs.

Placing

A placing is defined as a marketing of securities in issue but not yet listed or not yet in issue to specified persons or clients of the sponsor or any securities house assisting in the placing, which does not involve an offer to the public or to existing holders of the issuer's securities generally.[122]

Another type of placing is a 'vendor consideration placing'.[123] Such a placing occurs where there is a marketing by, or on behalf of, vendors of securities that have been allotted as consideration for an acquisition. A placing where no stock market listing is involved is unlikely to require a prospectus, as it is unlikely to be categorized as an offer to the public. Where a placing forms part of a listing whereby shares will be available for offer or subscription, then a prospectus may be required.

Intermediaries Offer

An intermediaries offer is a marketing of securities already or not yet in issue by means of an offer by, or on behalf of, the issuer to intermediaries for them to allocate to their own clients.[124]

'Intermediaries' are defined as an intermediary who is independent of both the sponsor of the offer and who does not assist in any way with the marketing of the offer.

Introduction

An 'introduction' is a method of bringing securities to listing that are already in issue and are widely held by the public.[125] An introduction is often used by companies listed on the Irish Developing Companies Market. It also is favored by overseas companies

121 Purple Book, para 4.5.
122 Purple Book, para 4.7.
123 'Vendor consideration placing' should be distinguished from 'vendor consideration issue', as described in the Purple Book, para 4.29.
124 Purple Book, para 4.10.
125 Purple Book, para 4.12.

whose securities are traded in other jurisdictions and who wish to obtain a secondary listing on the Irish Stock Exchange.

The Irish Stock Exchange will only admit securities to listing by way of an introduction where it is satisfied that the shares are so widely held that their marketability can be assumed.[126] No capital is raised by the applicant company as the purpose of an introduction is merely to list its securities rather than to make an offering to the public for purposes of raising finance.

Rights Issue

A rights issue is an offer to existing holders of securities to subscribe or purchase further securities in proportion to their holdings made by means of the issue of a renounceable letter of allotment, which may be traded for a period before payment for the securities is due.[127] To encourage existing shareholders to take up the offer, the offer is usually made at a discount.

The offer is accompanied by a circular detailing the offer, a provisional letter of allotment, and a renounceable letter which allows the shareholder to renounce their right to allotment in favor of another party should they so wish.[128] This type of offer must remain open for at least 21 days.[129] This facilitates trading of the entitlement to subscribe for securities.

In the case of equity securities, section 23(1) of the Company's (Amendment) Act 1983 provides for a statutory right of pre-emption. This means that, where a company proposes to offer new, unissued equity securities[130] in return for cash, it must first offer them to its existing members in proportion to their existing holdings. During the 21-day period following the making of the offer, an existing member may renounce his or her rights in favor of another party.[131]

Where the offer is for consideration otherwise than wholly in cash, the statutory right of pre-emption does not apply. It is worth noting that section 24 of the 1983 Act permits the disapplication of section 23 statutory pre-emption rights, ie, it permits that the directors of the company have the power to either disapply section 23(1) or modify its application where either an appropriate provision in the company's articles of association or, more usually, a members' special resolution[132] so permits.

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126 Purple Book, para 4.13.

127 Purple Book, para 4.16.

128 If no renounceable letter is used, then the offer becomes an 'open offer', in which event different Purple Book rules apply.

129 Purple Book, para 4.21(a).

130 'Equity securities' of the Companies (Amendment) Act 1983 as are defined in section 23(13), which will mean company shares or securities which may be converted into shares but does not include bonus shares; or shares shown in the memorandum to have been shares taken by a subscriber to the memorandum; or shares which in respect to dividends and capital carry restricted distribution participation rights; or shares which are held under an employee share scheme; or which, although not yet allotted, are to be allotted pursuant to such a scheme.

131 Companies (Amendment) Act 1983, s 23(3), such other party having the right to be admitted as a member of the company, subject to any restrictions in the company's memorandum and articles of association.

132 A special resolution requires a 75 per cent majority vote.

Open Offer

An open offer is an invitation to existing holders of securities to subscribe or purchase securities in proportion to their holdings.[133] This is not made by means of a renounceable letter of allotment and, thus, is unlike a rights issue in this regard. An open offer must be made using assignable or transferable application forms, with splitting facilities.[134]

The open offer also may be made in conjunction with other methods of issue. It is worth noting that a director may not, save in exceptional circumstances, apply for excess securities without those securities being offered to other existing shareholders on identical terms. An open offer may not be made where the securities are equity securities and are of a class already listed if the price is to be at a discount of more than 10 per cent of the middle market price of those securities at the time of announcing the terms of the open offer, unless the Stock Exchange is satisfied that the issuer is in severe financial difficulties or that there are other exceptional circumstances.[135]

Acquisition or Merger Issue

An acquisition or merger issue (or vendor consideration issue) is defined in the Purple Book as an issue of securities in consideration for an acquisition of assets, or an issue of securities on an acquisition of, or merger with, another company as consideration for the securities of that company.[136]

A company could use this method if it did not wish to finance an acquisition by means of borrowings or a rights issue.

Capitalization Issue

A capitalization issue is where a company opts to issue bonus shares to its existing members in proportion to their existing holdings rather than paying dividends, or for any other reason.[137] A capitalization issue does not involve the company raising any capital, as the funds to finance the issue come from company reserves.[138]

Issue for Cash

An issue for cash is an issue of securities for cash to persons who are specifically approved by the company's shareholders in general meeting, or an issue pursuant to a general

133 Purple Book, para 4.22.
134 Purple Book, para 4.23.
135 Purple Book, para 4.26.
136 Purple Book, para 4.27.
137 A prospectus is not required where a bonus issue is made as there is no requirement for the allotee to 'subscribe or purchase' the shares within the meaning of section 2(1) of the Companies Act 1963.
138 Purple Book, para 4.31.

disapplication of section 23 of the Companies (Amendment) Act 1983 approved by shareholders in general meeting.[139]

Such an issue for cash is not regarded as a placing where the subscribers are small in number and are named at the members' general meeting.[140] Paragraph 4.34 of the Yellow Book provides that securities of a class already listed may be granted a listing if they arise from an issue for cash, an exchange for, or a conversion into, another class of securities, or an exercise of options or warrants to subscribe for securities.

Offer to the 'Public'

The Companies Acts 1963–2003 makes it clear that a prospectus will not be required where shares or debentures[141] are not offered to the public.

Although private companies are prohibited from offering shares to the public,[142] nevertheless a private company is capable of making such an offer, with the consequence that a prospectus will be required.

Therefore, irrespective of the type of company involved, the central issue that arises in any proposed issue of shares or debentures in a company is whether or not the offer is intended to be made to 'the public'. The Companies Acts 1963–2003 provide no clear definition as to 'the public'. The Prospectus Directive states in its preamble that 'so far, it has proved impossible to furnish a common definition of the term ''public offer'' and all its constituent parts' which could be used throughout the European Union.

Section 61 of the Companies Act 1963 states that an offer to the public shall include offers of shares or debentures 'to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner'. The section intends that 'the public' may include a selected group of offerees, ie, a section of the public such as a group selected by virtue of being the most likely persons to be interested in an offer.[143]

139 Purple Book, para 4.33.
140 Purple Book, para 4.33.
141 Section 2(1) of the Companies Act 1963 defines shares as 'shares in the share capital of the company, and includes stock except where a distinction between stock and shares is expressed or implied' and 'debentures' as 'including debenture stock, bonds and any other securities of the company whether a charge on the assets of a company or not'.
142 Companies Act 1963, s 33(1)(c). Section 21 of the Companies (Amendment) Act 1983 makes it a criminal offence for the company and any of its officers to either offer any shares or debentures to the public, or to allot or agree to allot any shares or debentures with a view to any of them being offered for sale to the public. Section 21(3) states that section 21(1) does not, in any way, affect the validity of any allotment or sale or any agreement to allot or sell.
143 Article 2.1 of the Prospectus Directive does not require a prospectus if the offer is to a 'restricted circle of persons'. However, it does not elaborate any further on the point.

This subsection also provides that a group selected by virtue of their being members or debenture holders of the company concerned may be deemed to be a 'section of the public'. Therefore, a rights issue may be deemed to involve an offer to a 'section of the public'.[144]

A group 'selected in any other manner' can be deemed to be a 'section of the public'. Hence, in order for an offer to such groups to fall outside the prospectus requirement, clearly something more must be present before they will be deemed not to constitute 'the public'. Section 61(2) of the Companies Act 1963 provides that an offer will not be an offer to the public if either it is not calculated to result in persons acquiring the shares other than those receiving the offer or, alternatively, the offer can properly be regarded as a 'domestic concern of the persons making and receiving the offer'.

Unlisted Securities

A private company's articles of association prohibit it from offering shares or debentures to 'the public'. This raises the issue of whether such a company runs the risk that, when it issues securities to its members or debenture holders, it may be offering them to 'the public'.

Legislation provides that, although the company's articles may prohibit it from making offers to the public, it will not be taken to mean that it is prohibited from offering shares or debentures to its members or debenture holders.

Disclosure of Acquisition of Substantial Holdings

In General

As to the Irish Take-over Panel Act 1997 (Substantial Acquisition Rules) 1997, the Substantial Acquisitions Rules are made by the Irish Take-over Panel.[145]

The Substantial Acquisitions Rules are administered by the Panel in accordance with the Irish Take-over Panel Act 1997 (Take-over) Rules 1997. The Panel Executive is available for consultation on the application of the Substantial Acquisitions Rules, and rulings and directions relating to the Substantial Acquisitions Rules are given by the Panel on application by interested parties or on its own initiative.

The Substantial Acquisitions Rules reflect General Principle 12,[146] which provides that a substantial acquisition of securities, whether effected by single or multiple transactions, shall take place only at an acceptable speed and shall be subject to adequate and timely disclosure. These Rules are designed to restrict the speed with which a person may increase a holding of voting securities, and rights over such

144 Unless it remains within the parameters of section 61(2) of the Companies Act 1963.

145 The Substantial Acquisitions Rules are made pursuant to the provisions of section 8(2) of the Irish Take-over Panel Act 1997, Act Number 5 of 1997, and have been approved by the Minister for Enterprise and Employment as required by the Take-over Panel Act.

146 From the Schedule to the Irish Take-over Panel Act, 1997.

securities, of a relevant company[147] to an aggregate of between 15 per cent to 30 per cent of the voting rights of the relevant company.

The Rules also require the accelerated disclosure of acquisitions of rights related to such holdings. There are, however, a number of exceptions to this. The Panel has the role of elaborating rules to regulate substantial acquisitions by virtue of section 8(2) of the Act.

Prohibition

Rule 4 of the Substantial Acquisitions Rules prohibits a person from making 'a substantial acquisition' of securities except as permitted by the Substantial Acquisitions Rules.[148]

According to rule 3(a) of the Substantial Acquisitions Rules, an acquisition by a person of voting securities of a relevant company (or of rights over voting securities) shall be regarded as 'a substantial acquisition' if:

- Any voting securities or rights so acquired confer in the aggregate 10 per cent or more of the voting rights in the company; and
- Any voting securities (and rights over same) so acquired by that person confer 15 per cent or more, but less than 30 per cent, of the voting rights in the company when aggregated with any voting rights already held by that person.[149]

Should the person engage in a series of acquisitions of voting securities of a relevant company, then all such transactions will be aggregated within a seven-day period for the purpose of assessing whether the acquisitions constitute 'a substantial acquisition' in that period. If the acquisition represents less than 10 per cent of the total voting rights, then the proposed acquisition may be made.[150]

If the acquisitions represent more than 10 per cent of the total voting rights, then it is a question of whether that amount when aggregated with existing holdings would elevate the person's interest to between 15 per cent and 30 per cent. Should that be the case, then the acquisition may not proceed.[151] If the 30 per cent threshold is met or exceeded, then the Take-over Rules, in particular rules 5 and 9, may come into play and usually oblige the person to make a bid for the company.

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147 Irish Take-over Panel Act 1997, s 2.

148 Special provision is made for 'dealers' whereby the prohibition in rule 4 shall not apply to dealers who acquire substantial acquisitions and dispose of sufficient of them as determined by rule 4 thresholds by 12 noon the next day to a person unconnected to the seller, or where the dealer inadvertently purchases a substantial acquisition.

149 Note that, if the person is acting in concert with other persons, then their holdings will be aggregated for the purposes of rule 3 of the Substantial Acquisitions Rules calculations.

150 Any acquisitions made by any person acting in concert with that person during that period also must be aggregated; Substantial Acquisitions Rules, rule 3(b)(i).

151 This is subject to one of the exceptions of Substantial Acquisitions Rules, rule 5, being applicable.

The acquisition of new voting securities,[152] or of new or existing voting securities,[153] under an established share option scheme, or the acquisition of existing voting securities by the exercise of an option are not treated as an acquisition of voting securities for the purposes of rule 3(a) of the Substantial Acquisitions Rules. However, the acquisition of any such rights will count for agreegability purposes should the person subsequently acquire further voting securities in the company at any time in the future.

Exceptions

If a 'substantial acquisition' comes within one of the exceptions permitted by rule 5 of the Substantial Acquisitions Rules, it may proceed.[154] These rule 5 exceptions are where 'a substantial acquisition' is made in relation to voting securities (or rights over same) in a relevant company by a person who:

- Acquires voting securities (or rights over same) from a single securities holder,[155] and it is the only acquisition the person has made in the last seven days;
- Is engaged in a tender offer;[156]
- Immediately after the acquisition, announces a firm intention to make an offer under the Take-over Rules for the company concerned in circumstances where either the acquisition is made with the agreement of the offeree company's board, or the offer will be publicly recommended for acceptance by the board, and the acquisition is conditional on the announcement of the offer; or
- Before the acquisition, the acquiring person announced a firm intention to make an offer for the company concerned and the posting of the offer was not subject to a precondition.

Where the acquiring person or those acting in concert with him hold 30 per cent or more of the voting rights of the company, such a person will be subject to the Take-over Rules, rather than the Substantial Acquisitions Rules.[157] In such event, the person may be obliged to make a 'mandatory offer' under rule 9 of the Take-over Rules.

Obligation of Prompt Disclosure

A person who acquires voting securities (or rights over same) is obliged by rule 6 of the Substantial Acquisitions Rules to disclose the acquisition, as well as that person's total

152 This also includes acquisition of securities convertible into new voting securities (other than the purchase of rights pursuant to a rights issue); Substantial Acquisitions Rules, rule 3(a).
153 This also includes acquisition of rights over such securities; Substantial Acquisitions Rules, rule 3(a).
154 Substantial Acquisitions Rules, rule 3.
155 Substantial Acquisitions Rules, rule 5(b), elaborates further on the issue of 'single securities holder' to provide that acquisitions from persons who are members of the person's immediate family or from related group companies will be regarded as being from a single holder.
156 Substantial Acquisitions Rules, rule 7.
157 Substantial Acquisitions Rules, rule 5; note rule 5.1.

holding of voting securities (or rights over same) not later than noon on the business day following the acquisition[158] in the following circumstances:

- Where the aggregate of all voting rights[159] held by the person before the acquisition was less than 15 per cent, and after the acquisition has increased to, or is greater than, 15 per cent;[160] or
- The aggregate of the voting rights held by the person before the acquisition was between 15 per cent and less than 30 per cent, and after the acquisition has increased by more than one whole percentage.[161]

The notification must be made to the company concerned, the Company Announcements Office of the Irish Stock Exchange, and the Irish Take-over Panel.

The acquisition of new voting securities, or of new or existing voting securities under an established share option scheme, or the acquisition of existing voting securities by the exercise of an option are not required to be disclosed by rule 6. However, the acquisition of any such rights counts for aggregability purposes should the person acquire a disclosable acquisition of voting securities at any time in the future.

Insider Trading and Fraud

Common Law

The statutory regime[162] only applies to insider dealings in securities in respect of which the Irish Stock Exchange provides dealing facilities.[163] The Common Law remains relevant in certain instances[164] and, therefore, has not been rendered obsolete by the statutory regime in so far as such securities are concerned.

Rights at Common Law are very limited and, indeed, case law provides that company directors normally owe no fiduciary duties to the shareholders where acts of non-disclosure are relevant to the value of the company's securities.[165] The only way directors who are insiders can be punished is where they are found to have breached the fiduciary duty that they owe to the company itself.[166] Clearly, this is of limited use to aggrieved shareholders.

158 Substantial Acquisitions Rules, rule 6.
159 Whether this is of voting securities or of rights over such securities.
160 Substantial Acquisitions Rules, rule 6(a)(i).
161 Substantial Acquisitions Rules, rule 6(a)(ii).
162 Companies Act 1990, Act Number 33 of 1990; Cahill, *Corporate Finance Law* (2000).
163 Companies Act 1990, s 107.
164 It is the applicable law relating to insider dealing in non-quoted securities and securities in non-Irish companies.
165 *Percival* v *Wright* [1902] 2 Ch 421.
166 *Regal (Hastings)* v *Gulliver* [1942] 1 All ER 378.

Statutory Regime

Part V of the Companies Act 1990 provided a statutory regime for regulating insider dealings. The enactment of Part V was motivated by Ireland's obligation to implement the Insider Dealings Directive.[167] The Directive's preamble states that the Community wished to ensure that co-ordinated rules were adopted on insider dealings throughout the member states. Accordingly, the Directive laid down a set of requirements which all member states are obliged to ensure are reflected in their domestic law. Part V of the 1990 Act implemented the Directive in Ireland with effect from 27 December 1990.[168]

The legislation has improved the weak legal protection that the Common Law afforded the victims of insider dealings. However, this statutory regime only applies in respect of securities for which dealing facilities are provided by a 'Recognized Stock Exchange'.[169]

The legislation defines dealing as:

> Dealing in relation to securities means (whether as principal or agent) acquiring, disposing of, subscribing for or underwriting the securities, making or offering to make or inducing or attempting to induce a person to make or to offer to make, an agreement:
>
> (a) for or relating to acquiring, disposing of, subscribing for or underwriting the securities; or
>
> (b) the purpose or purported purpose of which is to secure a profit or gain to a person who acquires, disposes of, subscribes for or underwrites securities or to any of the parties to the agreement in relation to the securities.[170]

In other words, in order for the legislation to apply, there must be 'dealings' in the defined 'securities'.

'Securities', as defined in section 107 of the Companies Act 1990, includes any of the following interests in respect of which dealing facilities are or are to be provided by a recognized stock exchange:

- Share, debentures, or other debt securities, issued or proposed to be issued, whether in the state or otherwise;
- Any right, option, or obligation in respect of any of the securities in the first item, above;
- Any right, option, or obligation in respect of any index relating to the securities in the first item, above; and

167 Council Directive 89/592/EEC on Co-ordinated Regulations on Insider Dealing.
168 SI Number 336 of 1990.
169 Defined in section 107 of the Companies Act 1990 as meaning securities issued or proposed to be issued, whether in the state or otherwise, for which dealing facilities will be provided on a recognised stock exchange.
170 Companies Act 1990, s 107.

- Any interest as may be subscribed by the Minster with responsibility for legislation.

A recognized stock exchange is any exchange as designated by the Minister with responsibility, which provides facilities for the buying and selling of rights and obligations to acquire stock. At this time, the only such exchange so designated is the Irish Stock Exchange. Note that the definition of 'dealing' and 'securities' does not exclude 'off-market' dealings in securities in relation to which dealing facilities are provided by a recognized exchange.

The Act prohibits a party in possession of inside information from engaging in insider dealing.[171] The legislation defines inside information as 'information that is not generally available and which if it were so available would be likely materially to effect the price of the securities'.[172]

One notable difference between the Irish legislation and the Directive is that, under the Directive, inside information must be of a 'precise nature'.[173] The purpose of such was so that mere rumors and speculation at the stock exchange could not be taken as insider dealing. The Irish legislation has no such 'precise' requirement.

The legislation defines two types of 'primary insiders'.[174] First, a person may not deal in securities of the company if he is, or was at any time, in the preceding six months connected to the company[175] where he is in possession of inside information by reason of his so being connected to the company.[176] Second, a person may not deal in securities of another company if he is, or was in the previous six months, connected to a company which was proposing to enter into a transaction with the other company and the connected person has inside information relating to that transaction.

A secondary insider, or 'tipee',[177] is a person who is prohibited from dealing in securities of a company when in possession of information which is not generally available but if it were would be likely to materially affect the price of securities where this information was received, directly or indirectly, from another person, and where the tipee is aware or ought reasonably to be aware of facts or circumstances by virtue of which that other person is precluded from dealing under the legislation.[178]

The legislation also provides for categories of transactions which are exempt from the application of the provisions on insider dealing. These are very limited in nature.[179]

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171 The types of insider dealing are listed in section 108 of the Companies Act 1990.
172 Companies Act 1990, s 108.
173 Insider Dealing Directive, art 1.1.
174 The term 'primary insider' is not actually used in the Companies Act 1990, but it has been adopted extensively to differentiate between primary and secondary insiders.
175 Companies Act 1990, s 108(11).
176 Companies Act 1990, s 108(2).
177 The term 'tipee' is not actually used in the legislation but has been adopted extensively to differentiate between primary and secondary insiders.
178 Companies Act 1990, s 108(1).
179 Companies Act 1990, ss 108(9) and (10) and 110.

Yellow Book Model Code

Chapter 16 of the Yellow Book Model Code imposes restrictions on directors' dealings[180] in securities[181] of their own companies.

The purpose of the Code is to ensure that directors or connected persons[182] neither abuse price sensitive information[183] nor place themselves in a position where they might come under such suspicion.

The Code provides[184] that a director may not deal in any securities of the company at any time when he is in possession of unpublished price-sensitive information in relation to the company's securities.

Where a director proposes to deal in the company's securities, the Code provides that he may not deal unless he has first advised the chairman or a designated director of the company of his intention to deal. A written record must be kept by the company of any clearance requests made by directors, together with any clearances given in response thereto.[185] The Model Code goes on to ensure that directors are not granted clearance to deal during certain 'prohibited periods'.[186]

Insider Trading and Fraud — Extraterritorial Application

Potentially, the greatest deficiency with the scope of 'dealing' arose from the adoption of the Companies Act 1990 (Insider Dealing)[187] Regulations 1992, which confined the application of section 108 dealings taking place within Ireland.[188]

These Regulations provided that the statutory prohibition on insider dealing did not apply to dealing in securities outside of Ireland. The reason why Ireland adopted the 1992

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180 The Model Code defines 'dealing' as any acquisition or disposal of, or agreement to acquire or dispose of, any securities of the company and the grant, acceptance, acquisition, disposal, exercise or discharge of any option (whether for the call, or put, or both) or other right or obligation, present or future, conditional or unconditional, to acquire or dispose of securities, or any interest in securities, of the company whereby 'deal' shall be construed accordingly.

181 The Model Code defines 'securities' as meaning any listed securities and, where relevant, securities which have been listed or admitted to dealing on, or have their prices quoted on or under the Rules of NASDAQ or any investment exchange in a member state which provides facilities for the buying and selling of securities.

182 Yellow Book, para 16.13, defines 'connected persons' as persons defined in section 64 of the Companies Act 1990 whose interests in the company are treated as those of the director and such interests are, along with the director's interests in the company, notifiable pursuant to section 53 of the Companies Act 1990.

183 The Model Code defines 'unpublished price sensitive information' as per section 108(1), Companies Act 1990, but with the additional element that it must be 'specific or precise'.

184 Model Code, para 4.

185 Model Code, para 8.

186 For a description of these 'prohibited periods', see the three such periods specified under paragraph 7 of the Model Code.

187 Companies Act 1990 (Insider Dealing) Regulations 1992, SI Number 131 of 1992, repealed by section 6 of the Companies (Amendment) Act 1999 (Number 8 of 1999).

188 Cahill, *Corporate Finance Law* (2000).

Regulations was to ensure that stabilization efforts put into effect outside of Ireland (and which would presumably be adequately regulated by insider dealing rules in the other jurisdiction) were not inadvertently jeopardized by the application of the legislation.

The difficulty that arose was that a party accused of illegal dealing outside Ireland could invoke the 1992 Regulations as a defense when challenged. By confining the application of the legislative prohibitions to 'dealing' in securities within Ireland, the government had satisfied the minimum requirements required or the Insider Dealing Directive,[189] but allowed the insider dealer dealing outside Ireland to proceed unhindered.

The Companies (Amendment) Act 1999[190] has recently been enacted to deal with this situation. This Act revoked the 1992 Regulations. Thus, a person who deals outside Ireland in securities listed in Ireland can no longer avail of the lacuna in the 1992 Regulations.

Liabilities for Insider Trading and Fraud

The legislation provides for both civil and criminal liability. Civil liability extends to compensate a party to a transaction not in possession of the relevant information for any loss sustained by reason of the difference in price at which the securities were traded and the price at which they would have been likely to have been dealt in if the information had been generally available, and to account to the company who issued the securities for any profit accruing. Any action under this provision must be made within two years of the date of completion of the transaction giving rise to the claim.

Section 111 imposes criminal liability on a person who deals in securities in a manner declared unlawful by Section 108. The criminal liability for inside dealing includes penalties on conviction on indictment of fines of up to €253,947.62 and prison terms of up to a maximum of 10 years. A summary conviction results in fines of up to €12,697.38 or up to 12 months' imprisonment or both.[191] The Act, however, is silent as to the requisite intention required of the dealer.

A recent Circuit Court decision addressed that issue and held that the prosecution must prove that the defendant intended to profit by using the price-sensitive information.[192] This means that criminal convictions for insider dealing will be difficult to achieve and that the regulatory authorities will be more cautious when deciding whether to prosecute. The Office of the Director of Corporate Enforcement (ODCE) is now charged with investigating alleged instances of insider dealing following the enactment of the Company Law Enforcement Act 2001, which amended section 115 of the Companies Act 1990. There is a statutory duty on the Irish Stock Exchange to provide the Director of Corporate Enforcement with a report of its findings if it appears that, following its investigation, an

189 This includes off-market dealings.
190 Following a report in the 1994 Company Law Review Group (First Report) (December 1994). Companies (Amendment) Act 1999, Act Number 8 of 1999.
191 Companies Act, 1990, ss 11 and 114.
192 *DPP* v *Philip Byrne* (February 2002), Circuit Court.

offence has been committed under Part V of the Companies Act 1990.[193] The Director of Corporate Enforcement will then report all relevant offences to the Director of Public Prosecutions who is responsible for prosecuting offences under the Act.

Acquisition may be subject to sections 4 and 5 of the Competition Act 2002, save where those mergers or acquisitions have been put into effect with Part III of the Competition Act 2002. The Competition Authority has now been established as the main regulator of mergers by virtue of the Act,[194] although it should be noted that media mergers (regardless of their size) must be notified to the Minister for Enterprise, Trade and Employment.[195]

Public Take-Over Bids

In General

Regulation in regard to public take-overs involves two pieces of legislation. Where a take-over involves a company whose securities are listed, the regime introduced by the Irish Take-Over Panel Act, 1997 and the Panel's Take-Over Rules may be applicable.

In addition, the provisions of Part III of the Competition Act 2002[196] will apply where the merger or acquisition meets or exceeds certain asset or turnover thresholds set out in the 2002 Act. Where those thresholds are met, the merger or acquisition will require notification to the Competition Authority seeking clearance under the 1978 Act. Additionally, a merger or acquisition may be subject to Sections 4 and 5 of the Competition Act 2002, save where those mergers or acquisitions have been put into effect with Part III of the Competition Act 2002. The Competition Authority has now been established as the main regulator of mergers by virtue of the Act,[197] although it should be noted that media mergers (regardless of their size) must be notified to the Minister for Enterprise, Trade and Employment.[198]

Procedural Requirements

Under the Competition Act 2002, where there has been a 'merger' or 'acquisition', such 'merger' or 'acquisition' is notifiable to the Competition Authority where:

- In the most recent financial year, the world-wide turnover of each of two or more of the undertakings involved is not less than €40 million;
- Each of these undertakings carries on business in any part of the island of Ireland; and
- One of the undertakings has a turnover in the State which is not less than €40 million.[199]

193 Companies Act 1990, s 115.
194 Competition Act 2002, s 30.
195 Competition Act 2002, s 23.
196 Mergers, Take-overs, and Monopolies (Control) Act 1978, Act Number 17 of 1978.
197 Competition Act 2002, s 30.
198 Competition Act 2002, s 23.
199 Competition Act 2002, s 18(1)(a).

Notwithstanding these thresholds, the Minister for Enterprise, Trade and Employment may order that certain types of mergers and acquisitions are notifiable where the exigencies of the common good so warrant.[200] A failure to notify a notifiable merger or acquisition — or to supply information required in relation to a notified merger or acquisition — can result in significant fines (€3,000 on summary conviction or €250,000 on conviction on indictment).[201] A notifiable merger or acquisition will, where it is not notified, also be void.[202]

The Authority has stated that, for the purpose of calculating turnover and assessing whether business is carried on in Ireland, the term 'undertakings involved' means the entire group of companies to which a merging company belongs. The Authority further stated that the term 'carries on business in any part of the island of Ireland' will include undertakings which have sales into the State without having a physical presence within the State. It also considers that 'turnover in the State' will include turnover generated from sales within the State, sales out of the State and sales into the State.

All media mergers require to be notified regardless of the turnover of the undertakings involved.[203] Mergers which do not reach the turnover thresholds can be voluntarily notified to allow the notifying parties to seek immunity from attack under sections 4 and 5 of the Act.[204]

Section 18(1) of the Competition Act requires that each of the enterprises involved in the proposed merger or acquisition (which meet the aforementioned thresholds) shall notify the Authority in writing of the proposal of such 'merger' or 'acquisition' and provide full details within one month after the conclusion of the agreement or the making of the public bid. Notifications are to be made by each of the undertakings involved using the prescribed Form M1 or Form M2. The form can be filled in on a joint basis, or separate notifications may be made by each party. A fee of €8,000 is prescribed for each notification.[205]

Where foreign companies are involved, details of any other merger clearances that are required in any other jurisdiction are requested to be supplied to the Competition Authority, together with details of whether such enterprises have been the subject of competition law proceedings in any jurisdiction.

The authority has one month in which to decide that:

- The merger or acquisition will not substantially lessen competition in the state and, therefore, should be put into effect; or
- It intends to open a four-month investigation (a 'full investigation') into the proposed 'merger' or 'acquisition'.[206]

200 Competition Act 2002, s 18(1)(b) and (5).
201 Competition Act 2002, s 18(9).
202 Competition Act 2002, s 19(1).
203 Competition Act 2002, s 18(5), Order 2002.
204 Competition Act 2002, s 18(3).
205 Competition Act 2002 (Notification Fee) Regulations 2002.
206 Competition Act 2002, s 21(2).

The initial one-month period will be extended to 45 days in the event that the Authority is required to consider proposals from the parties as to how any competition concerns expressed about the merger in the Authority notifying undertakings' discussion might be modified for the better.

Where the Authority opens a section 22, four-month investigation, it must make one of three decisions, namely, to:

- Permit the merger;
- Prohibit the merger; or
- Permit the merger subject to conditions that it will specify.[207]

The Irish Take-over Panel Act 1997 provides for the creation of the Irish Take-Over Panel, a domestic body charged with the orderly regulation of take-overs of listed companies in accordance with the rules of fair conduct and good commercial standards. The Irish Panel's Rules have been drawn up in accordance with a set of 12 general principles scheduled in the Irish Take-over Panel Act 1997. These rules are as follows:

- All shareholders as the same class of the offeree will be treated similarly by an offeror;
- Where information is tendered by the offeror or offeree or their respective advisers to shareholders of the offeree in the course of any offer, it must be made available equally to all of the shareholders who may accept the offer;
- No offer may be made and no announcement of a proposed offer may be made save after careful and responsible consideration of the matter by the offeror and any advisers of the offeror and only if the offeror and any advisers of the offeror are satisfied that the offeror will be able to implement the offer if it is accepted;
- Shareholders to whom an offer is made shall be entitled to receive such information and advice as will enable them to make an informed decision on the offer;
- It is the duty of all parties to a take-over or other relevant transaction to prevent the creation of a false market in any of the securities of the offeror or offeree and to refrain from any statement or conduct which could mislead shareholders or the market;
- It is the duty of the directors of an offeree when an offer is made or when they have reason to believe that the making of an offer is imminent to refrain from doing anything as respects the conduct of the affairs of the offeree which might frustrate that offer or deprive shareholders of the opportunity of considering the merits of the offer, except on the authority of those shareholders given in general meeting;
- Directors of the offeree shall give careful consideration before they enter into any commitment with an offeror (or any other person) which would restrict their freedom to advise shareholders of the offeree in the future;
- Directors of the offeree and (if it is a company) of the offeror owe a duty to the offeree and the offeror, respectively, and to the respective shareholders of those companies to act in disregard to personal interest when giving advice and furnishing information in relation

207 Competition Act 2002, s 22(3).

to the offer; in discharging that duty, the directors will be bound to consider the interests of the shareholders as a whole;

- Rights of control must be exercised in good faith, and the oppression of a minority is not acceptable in any circumstances;
- Where an acquisition of securities is contemplated as a result of which a person may incur an obligation to make an offer, he must, before making the acquisition, ensure that he can and will continue to be able to implement such an offer;
- An offeree ought not to be disrupted in the conduct of its affairs beyond a reasonable time by an offer for its securities; and
- A substantial acquisition of securities (whether such acquisition is to be effected by one transaction or a series of transactions) may take place only at an acceptable speed and will be subject to adequate and timely disclosure.

Exceptions

Rule 5.2 of the Take-over Rules provides for a number of exceptions where the restriction on acquisitions of voting securities or of rights over such securities may be permitted.

Common to several of these situations is that each involves the making of a 'firm intention announcement', either immediately before or after the substantial acquisition, and there is a friendly reception on the part of the offeree's board towards the offer. Acquisition is permitted by a person:

- Who acquires voting securities (or rights over same) from a single[208] securities holder and it is the only such acquisition the person has made in the last seven days;[209]
- Immediately before the announcement of the person's firm intention to make an offer under the Take-over Rules for the company in circumstances where either the acquisition is made with the agreement of the offeree board or the offer will be publicly recommended for acceptance by the board, and the acquisition is conditional on the announcement of the offer;
- Immediately after the person announces a firm intention to make an offer in respect of the company, provided that such acquisition satisfies a precondition of the posting of the offer and that the offer has been publicly recommended for acceptance by the offeree board, or the acquisition is made with its agreement;
- After the person has announced a firm intention to make an offer in respect of the company, provided that the posting of the offer is not, at the time of acquisition, either made with the agreement of the offeree board, or the offer or any competing offer has been publicly recommended for acceptance by the offeree board; or

208 Take-over Rules, rule 5.2(b), elaborates further on the issue of 'single securities holder' to provide that acquisitions from persons who are members of the person's immediate family or from related group companies will be regarded as being from a single holder.

209 Take-over Rules, rule 5.2(a)(i), elaborates by providing that this exception shall not apply if such person has announced a firm intention to make an offer in respect of the company and the posting of the offer is not subject to any preconditions.

- If the acquisition is by way of acceptance of an offer made in accordance with the Rules.

Jurisdictional Conflicts

In General

A broad reading of the phrase 'jurisdictional conflicts' yields a number of possible contexts in which such a conflict could arise in relation to securities regulation, *inter alia*:

- Conflicts between the substantive requirements of the listing rules of various stock exchanges both inside and outside Europe; and
- Conflicts arising in the context of private international law as to the applicable law in an international contract, as to the correct jurisdiction in which to initiate court proceedings in the event of a dispute, as to the procedural rules applicable in the event of such a dispute, and regarding the enforceability of judgments obtained in the crossborder context.

Multilateral Approach

Substantive Requirements of the Yellow Book

The European Communities (Transferable Securities and Stock Exchange) Regulations 1992, the Purple Book, and the Companies Act 1963, as amended (in so far as they relate to foreign companies seeking listing on the Irish Stock Exchange), have been discussed above.

Chapter 17 of the Purple Book sets out the requirements and exemptions in respect of foreign companies;[210] however, the Irish Listing Rules and the Companies Act 1963 should be read as one. Therefore, filing requirements in respect of foreign companies under the Companies Act 1963, although not necessarily referred to in the Listing Rules, must nevertheless be complied with.[211]

It is recommended that, where there is an apparent conflict in the application or listing requirements of the various European and international stock exchanges, a company seeking listing on more than one exchange determines which of the exchanges has the most stringent requirements and tailors its listing application, prospectus, and forms of compliance accordingly.

The practice of the Irish Stock Exchange in the event of a conflict of disclosure requirements is to accept disclosures made under a more stringent stock exchange regime to require more exacting compliance where this is necessary under the Irish Stock Exchange

210 'Foreign companies', for the purposes of the Irish Stock Exchange, are companies registered outside the Republic of Ireland.

211 For example, Parts XI and XII of the Companies Act 1963 deal with companies incorporated outside the state establishing a place of business within the state, and restrictions on the sale of shares and offers of shares for sale, respectively. The Combined Companies Acts, which are well indexed are the best reference point for those seeking to ensure compliance in this regard.

rules. The Rules offer guidance on such discretionary areas in paragraph 17.11. Directors should be aware of ongoing obligations, eg, disclosure requirements.

Where multiple listing is sought and the various stock exchange requirements as to accounting principles and methods of financial reporting differ in respect of listing particulars, if accounts prepared over three years are consolidated accounts in respect of the applicant and all its subsidiary undertakings and have been prepared in accordance with the applicant's national law (which must comply with either Irish or American Accounting Standards, such as Generally Acceptable Accounting Standards) in all material respects and are independently audited, they will most likely be acceptable to the Irish Stock Exchange, subject to paragraph 17.3 in respect of overseas companies.

It is suggested that, where necessary, a supplement be added to the documents submitted as the listing particulars in the form of a statement of adjustment outlining the differences in accounting methods required in one jurisdiction from those employed in another. Chapters 12 and 17 of the Purple Book should be consulted in detail as, although there is a growing trend towards globalization of capital markets, the levels of transparency of accounting methods do still differ.

Private International Law

As outlined, jurisdictional conflicts can arise in the contexts of a substantive law, territoriality, procedurally, or in the context of enforcement of judgments.

Genuine and False Conflicts

In General

What might at first seem to pose a jurisdictional or conflict of laws problem can be resolved by reference to international conventions which have been designed to harmonize the rules relating to conflicts of laws and by deciding under which jurisdictional penumbra the particular conflict falls.

The Listing Rules of the Irish Stock Exchange, the Purple Book, and the Exchange itself respectively, constitute the national regulatory infrastructure and regulatory body giving effect to the European Community Directives which protect investors and regulate listings on the markets.[212]

Therefore, in the event that a conflict of rules, procedures, or jurisdictional and sovereignty matters is not addressed by the Purple Book, international conventions are the next reference point in resolving any cross-jurisdictional issues, always bearing in mind that Irish company law requirements must be complied with.

212 Council Directive 79/279/EEC (the Admission Directive), Council Directive 82/121/EEC (the Interim Reports Directive), Council Directive 80/390/EEC (the Listing Particulars Directive), Council Directive 88/627/EEC (the Major Shareholding Directive), Council Directive 89/298/EEC (the Public Offers Directive), and their subsequent amending Directives.

For business efficacy reasons, companies outside Ireland clearly have an interest in being able to enforce their international contracts and protect themselves from suits in myriad countries based on countless rules of law. The Brussels Convention[213] and the Rome Convention,[214] as implemented by Irish legislation,[215] contain the rules governing the matters of territorial jurisdiction and choice of law, respectively, but they give parties the right in articles 3 and 17, respectively, to contractually agree on these matters for themselves.

Choice of Law

Where a contract is concluded between two or more parties in different jurisdictions concerning a matter in another jurisdiction, confusion can arise as to the legal rules to be applied in the case of a dispute.

The purpose of the Rome Convention is to provide a domestic law code for resolving choice of law problems in contract and to prevent 'forum shopping' which had arisen following the signing of the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters.

Article 1 provides that its rules 'apply to contractual obligations in any situation involving a choice of laws of different countries'. Article 2 requires that any law specified under the Convention be applied whether or not it is the law of the contracting state. Therefore, it replaces all the previous Irish private international law applicable to international contracts whether or not they have a European dimension. As stated, parties are free to choose the legal rules by which a contract is to be governed.[216]

In the event that no applicable law is chosen, the contract 'shall be governed by the law of the country with which it is most closely connected',[217] which in turn is determined by reference to:

> . . . where the party who is to effect the performance which is characteristic of the contract has, at the time of the conclusion of the contract, his habitual residence, or in the case of a body corporate or unincorporate, its central administration.[218]

However:

> . . . if the contract is entered into in the course of that party's trade or profession, that country shall be the country in which the principal place of business is situated or,

213 Brussels Convention 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (subsequently amended by the San Sebastian Convention).

214 Rome Convention 1980 on the Law Applicable to Contractual Obligations.

215 The Brussels Convention was implemented into Irish law by the Jurisdiction of Courts and Enforcement of Judgments (European Communities) Act 1988 (Number 3 of 1988) and the San Sebastian Convention by the Jurisdiction of Courts and Enforcement of Judgments Act 1993 (Number 8 of 1993). The jurisdiction of the 1988 and 1993 Acts has been consolidated by the Jurisdiction of Courts and Enforcement of Judgments Act 1998, Act Number 52 of 1998. The Rome Convention was implemented by the Contractual Obligations (Applicable Law) Act 1991 (Number 8 of 1990).

216 Rome Convention, art 3(1).

217 Rome Convention, art 4(1).

218 Rome Convention, art 4(2).

> where under the terms of the contract is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated.[219]

The law governing certain contractual matters, ie, interpretation, performance, consequences of breach, prescription and limitation of actions, and contractual nullity,[220] under the terms of the Convention (if it were valid), is the governing law. The governing law is the law of the place where the company has its central administration, subject to the proviso in article 4(5).[221]

Contracts concluded between persons who are in the same country are:

> . . . formally valid if [they] satisfy the formal requirements of the law which governs [them] under this Convention or of the law of the country where [they are] concluded . . .[222]

whereas:

> . . . a contract concluded between persons who are in different countries is formally valid if it satisfies the formal requirements of the law of one of those countries.[223]

Company law issues relating to internal structure and workings or the personal liability of members are one of the major exceptions to the scope of the Convention, ie, the governing law is that of the country in which the company is incorporated.[224]

Territorial Jurisdiction

Territorial jurisdiction is concerned with the court in which an action can be brought; if a court cannot establish jurisdiction under the Convention, then it must refuse to hear the case. The Brussels Convention states that, in civil and commercial matters, 'persons domiciled in a member state are to be sued in that state'.[225] Part III of the Schedule to the Jurisdiction of Courts and Enforcement of Judgments Act 1988 provides that a company is domiciled in the place of incorporation or where its central management and control is exercised.

An exception to this rule is that, in 'matters relating to contract', defendants may be sued in their state of domicile or in the state which is the place of performance of the obligation in question. In determining the 'obligation in question', various courts have looked at the main purpose of the contract and the Irish courts in particular have simplified the analysis by saying that the 'obligation in question' means that which is the subject matter of the

219 Rome Convention, art 4(2).
220 Rome Convention, art 10.
221 Rome Convention, art 8(1).
222 Rome Convention, art 9(1).
223 Rome Convention, art 9(2).
224 Rome Convention, art 2(e).
225 Brussels Convention, art 2.

particular proceedings.[226] The Brussels Convention only applies to a legal dispute between states that are member states of the European Union.

Procedural Law

Evidence and procedure fall outside the scope of the Conventions, but they are governed by the rules of the state in whose courts the dispute is being heard, subject to the modification in article 14 of the Rome Convention, which states that:

> . . . the law governing the contract under this Convention applies to the extent that it contains, in the law of contract, rules which raise presumptions of law or determine the burden of proof.[227]

The effect of article 14(2) is that a forum's rules as to modes of proof are not to have the effect of invalidating a contract formally valid under the terms of article 9.

Enforceability of Judgments

As between the member states of the EU, the Brussels Convention, articles 31–35, provides for an application to be made to the relevant judicial authority for recognition and enforcement of a foreign, ie, another EU member state judgment. The relevant application in Ireland is made to the Master of the High Court, pursuant to Order 42A of the Rules of the Superior Courts.

The courts are bound, under the Convention, to grant an order for enforcement, assuming the application procedures have been correctly followed, unless grounds of public policy or a judgment in default of appearance obtained in the absence of fair notice can be established as grounds to block the order.[228]

The European Court of Justice has held that the Convention does not apply to proceedings for the enforcement of judgments given in civil and commercial matters in non-contracting states.[229]

The Common Law position in Ireland with respect to recognition and enforcement of foreign (ie, 'non-EU') judgments (which is appropriate in disputes outside the ambit of the Brussels Convention) is that the foreign court must have had 'jurisdiction' under Irish conflicts of law rules.

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226 *nidare plc et al* v *James Scott Ltd* [1991] 2 IR 88 (Supreme Court).
227 Rome Convention, art 14(1).
228 Brussels Convention, arts 27 and 28.
229 *Owens Bank Ltd* v *Bracco* (Case 129/92) [1994] QB 509, reference from the House of Lords to the European Court of Justice.

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Israel

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Introduction

In General

The securities laws in Israel are governed, for the most part, by the Securities Law[1] and related regulations.[2] The entity which supervises and is responsible for the application of the securities laws is the Israeli Securities Authority (the "Authority" or the "Securities Authority"), under whose supervision the Stock Exchange, which is in charge of the trade in securities in public possession, operates.

Market Players

Securities Authority

The Securities Authority was established pursuant to the Securities Law (may be also referred to as the "Law"). Its function is to preserve the interests of the public investing in securities, as stipulated in the Law. The Authority is a corporation, legally competent with respect to any duty, right, or legal action.

The arrangements for dealing with applications for publication of prospectuses are prescribed by the Securities Authority with the approval of the Minister of Finance. Anyone considering himself injured by a decision of the Securities

1 Securities Law 5728-1968.

2 As of February 1st 2000, some of the securities related issues mentioned hereunder are governed by the new Israeli Companies Law, 1999, and related regulations. Among the key issues in the securities laws and in the course of operations of public companies, which were formalised pursuant to the new Companies Law and/or the regulations enacted pursuant thereto, the following are included, *inter alia*: class action, special and full purchase offer, relief to public companies whose securities are listed for trading on a stock exchange outside Israel, a chapter on transactions with interested parties, relief in transactions with interested parties, and voting in general meetings of shareholders by means of voting instrument or through the Internet.

Authority has the right to appeal to the Economic Division of the Tel Aviv District Court.[3]

Stock Exchange

In General. Trading in securities is performed via the Tel Aviv Stock Exchange. There is no other licenced stock exchange in Israel for trade in securities.

Pursuant to the Securities Law, opening and managing a stock exchange in Israel is subject to a licence granted by the Minister of Finance, following his consultation with the Securities Authority.[4] A licence to manage a stock exchange will be granted only to a company which does not limit the number of its members and:

- Whose Memorandum of Incorporation specifies that its exclusive objective is to manage a stock exchange;
- Whose Articles of Incorporation ensure that its profits will serve only for its objectives and will not be distributed among its members, provided that upon liquidation, the remainder of its assets shall be used for purposes stipulated by the Minister of Finance. This provision will apply only following the grant of two or more such licences;
- Which has enacted regulations as provided by the Law and such regulations have been approved by the Minister of Finance after consultation with the Securities Authority and by the Knesset Finance Committee; and
- Which manages its stock exchange in a city where no other stock exchange has yet been established.

Pursuant to the Securities Law, the rules for conducting trade in the Stock Exchange are regulated by the Stock Exchange Regulations, which, *inter alia*, establish rules for the regular and fair management of the Stock Exchange in the following fields:

3 Courts Law [Integrated Version] -1984, s 42D. The Economic Division of the Tel Aviv District Court was established according to the Courts Law (Amendment no. 59), 2010 and it commenced its operation on December 15, 2010. The Economic Division focuses on financial cases arising from both Securities Law and Companies Law, and, *inter alia*, has exclusive jurisdiction over most civil cases regarding the Companies Law and the Securities Law, including derivative claims and class action suits, administrative appeals against the Israeli Securities Authority, the Tel Aviv Stock Exchange and the Israeli Registrar of Companies. The major purpose of the Economic Division is to address the complexity which very often accompanies cases of this sort.

4 Securities Law, ss 45–52.

Rules with Respect to Membership in Stock Exchange. Rules with respect to membership in the Stock Exchange include those relating to:

- Terms of eligibility for membership on the Stock Exchange and the procedure for admitting members;
- The spectrum of activities permitted to a member of the Stock Exchange;
- Duties of the members *vis-à-vis* the Stock Exchange and its members, including the duties of disclosure, recording, and reporting;
- Rules of behaviour for members of the Stock Exchange *vis-à-vis* their clients, including the duties of disclosure, recording, and reporting;
- The Stock Exchange's supervision and control of its members' compliance with the Stock Exchange's regulations and directives;
- Disciplinary offences by members of the Stock Exchange and jurisdiction with respect thereto;
- Terms and procedure for suspending and terminating the membership of a member of the Stock Exchange; and
- Application of the above rules, *mutatis mutandis*, to a company operating within the fields of activity permitted to a member of the Stock Exchange, which is controlled by a member of the Stock Exchange or by a party holding a controlling interest therein.

Rules for Registration of Securities for Trade on Stock Exchange. Rules for registration of securities for trade on the Stock Exchange (hereinafter, 'registration for trade') include those relating to:

- Specifications of a company whose securities may be registered for trade, regarding the period of its operation, the volume of its operation and business results, the value of its assets and liabilities, its relationship with other corporations, and its classification in registration groups, and various rules as above established in accordance with the economic activity in which the company engages;
- Specifications of the securities which may be registered for trade, regarding class, overall minimum value at the time of registration, the minimum proportion that will be in the possession of the public immediately after registration and the degree of dispersal thereof, and the maximum number of classes or series;
- The ratio between the price of the securities on issue and the price of the company's securities on the Stock Exchange and the manner in which the securities were issued and allocated;
- Registration for trade of securities allocated under a private offering;
- Prevention of any transaction or action with respect to securities in the possession of an individual or class, for a period to be determined;
- Obligation of the company to ensure that all shares of its issued capital will be fully paid-up;

- Obligation of the company that any and all shares of its issued capital will be registered for trade, with an exception for industrial companies to which the Law of Encouragement of Industry (Taxes) applies and companies whose share capital includes special state shares.[5]
- Obligation of the company that all its securities shall be registered for trade in the name of a registration company, with certain exceptions to this rule, including those regarding companies whose securities are listed for trade on a stock exchange outside of Israel and companies incorporated outside of Israel.

Rules with Respect to Trading on Stock Exchange. Rules with respect to trading on the Stock Exchange include those relating to:

- Trading days;
- Conducting trade in various trading groups and methods;
- The Stock Exchange's supervision and control of compliance with the provisions and directives of the Stock Exchange's regulations, and proper conduct of trading;
- Terms and procedures for temporary cessation or restriction of trade in a particular security or group of securities;
- Exclusivity of trade to members of the Stock Exchange and to whom the Stock Exchange has approved, and the terms of such approval;
- Publication of the results of trading; and
- Terms and procedure for conducting transactions outside the Stock Exchange by members of the Stock Exchange, in securities registered for trade on the Stock Exchange.

Duties of Company Whose Securities Are Registered for Trade. Duties of a company whose securities are registered for trade include those relating to:

- Continued compliance with the rules stipulated for registration for trade, even after registration, with the changes deriving from the fact that the securities of the company are registered for trade;
- The duty of giving notice of types of events and information as required by the Stock Exchange;

The Stock Exchange Regulations also address the following issues:

- Terms and procedure for suspending trade in securities or erasing a security from registration for trade, including erasure on the initiative of the registered company;

5 Stock Exchange Regulations, s 71.

- Publication of information by the Stock Exchange, including information relating to the trade, members of the Stock Exchange, and registered companies; and
- Commissions, registration fees, and handling fees for the Stock Exchange's services.

The Stock Exchange Regulations shall apply also to a corporation that is not a company and to units of a closed fund as defined in the Joint Investment Trust Law, if such corporation or units are registered for trade, and the adjustments required therefore.

The Stock Exchange Regulations may stipulate that the Stock Exchange's Board of Directors has the right to refuse to register securities for trade on the Stock Exchange if in its opinion there is a substantial conflict of interests between the company and a controlling party therein, or between the company and a company controlled by the controlling party, provided that the resolution is adopted by the majority of two-thirds of the members of the Board of Directors participating in the meeting and eligible to participate in the vote and provided that the company has been given proper opportunity to present its position in writing to the Board of Directors. The rules of the Stock Exchange and any amendment to such rules may determine provisions in addition to those set forth therein.

The Stock Exchange Board of Directors has the right to stipulate, subject to Securities Authority's approval, directives including details, terms, and reservations with respect to the rules established in the Regulations, if expressly authorised in the Regulations.

The Stock Exchange has the right, with the Securities Authority's approval, to issue temporary directives for a period of one year on the aforesaid matters, in order to examine them before they become established as permanent directives in the Stock Exchange Regulations.

Anyone considering himself injured by a decision of the Stock Exchange has the right to appeal (i) to the District Court, if such decision was made in the course of disciplinary proceedings; and (ii) to the Economic Division of the Tel Aviv District Court, in case of any other decision, provided such decision was not made during the course of trade on the Stock Exchange or does not refer to the by-laws or provisions of the Stock Exchange; notice of commencement of such proceedings shall be submitted to the Authority, and the Authority has a right to present its opinion to the court during the said proceedings.

The Stock Exchange Board of Directors has the right to alter the Stock Exchange Regulations, with the approval of the Minister of Finance after consultation with the Securities Authority and with the approval of the Knesset Finance Committee. The Authority also has the right to cause the Regulations to be altered, with the Stock Exchange's consent, or by application to the Minister of Finance for an

order to alter the Regulations, with the approval of the Knesset Finance Committee.

The Securities Law stipulates that the Stock Exchange's activities will be continuous and it may not be closed down unless, in its opinion, or in the opinion of the Minister of Finance, it is necessary to do so for the benefit of the investing public. The Stock Exchange is under the supervision of the Securities Authority. It is the Securities Authority's duty to supervise the proper and fair management of the Stock Exchange and to instruct the Stock Exchange on its actions in case the Authority believes that the Stock Exchange is acting in contrary to its regulations or directives or in a manner which might impair its proper and fair management.

Procedures

Securities Definition

'Securities' are defined in the Securities Law as certificates issued in series by a company (including a foreign company), cooperative society, or any other corporation, conferring the right of membership or participation therein or claim thereon, and certificates conferring the right to purchase securities, whether or not they are 'registered in the name of' or 'to bearer', excluding securities issued by the Israeli government or Bank of Israel which comply with one of the following:

- They do not confer a right of participation or membership in a corporation and they are not convertible into or exercisable as securities conferring such right; and
- They are issued under special legislation.

It should be noted that the securities traded on the Stock Exchange are not limited solely to those that fall under this definition.[6]

Rules of Dual Listing and Trend of Globalisation

By 2000, a general determination was included in the Securities Law whereby when securities of a corporation registered abroad are offered to the public in Israel, the Securities Authority may exempt the offeror from the requirements of the Securities Law, in whole or in part, if it is convinced that the laws of the state in which the corporation is registered adequately secure the interests of the Israeli investors. The authority to grant such exemptions was left, pursuant to this arrangement, to the full discretion of the Securities Authority.

In view of the trend of globalisation that characterises international capital markets, the Israeli legislator decided in 2000 to amend and expand, within the

6 Securities Law, s 1.

framework of the rules of dual listing in the Securities Law,[7] the legislative arrangement which was practised up to that time, to encourage and attract companies incorporated in Israel whose securities are listed for trading on a stock exchange abroad, to join the Israeli capital market. As a result, the Securities Law enables these companies to list their securities for trading in Israel, without being required to publish a prospectus, but a listing document only,[8] and without subjecting themselves to the regular, current reporting obligations that apply to corporations whose securities were offered to the public pursuant to a prospectus,[9] all subject to the various restrictions as set forth below. This trend was intended to give these companies convenient access to the listing of their securities in Israel, without burdening them with the costs entailed in the listing and reporting procedures in accordance with the two parallel systems of laws. The preliminary threshold requirements for listing for trading under the dual listing rules are as follows:

- The company is required to be traded for a year on any of the NASDAQ Capital Market, the London Stock Exchange's Main Market (official list of the United Kingdom Listing Authority), Primary Listing; and following stock exchanges: NYSE, AMEX, or NASDAQ, and NASDAQ global market;[10] or
- The shares of the company are listed for trading on one of the stock exchanges and the market value of its shares is at least US $150 million.

The aforesaid rules of dual listing shall also apply to a foreign corporation if (i) the Authority and the foreign securities authority in the state in which the corporation was incorporated, have signed an agreement recognizing mutual equivalence of the laws and directives applicable in the State of Israel and in said state of incorporation, with respect to regulation, control and enforcement within the capital market (the "Recognition Agreement"); and (ii) the characteristics listed in Schedule 3-B of the Law are true with regard to the corporation and the securities whose listing is sought, including the characteristics concerning the country in which the corporation was incorporated, the exchange outside of Israel in which the securities are listed or in which they will be listed, and the type of securities.

As of the date of this publication, the requirements of Schedule 3-B apply to a corporation incorporated in France; that is traded on any market that has been licensed by Autorité des Marchés Financiers in accordance with the European Council directive 39/2004 and its traded securities are shares.

These preliminary requirements are the fruits of the conceptual balancing of interests between the aspect of encouraging and attracting the said companies to

7 Securities Law, ch E3.
8 Securities Law, s 35Q.
9 Securities Law, s 35AE.
10 Securities Law, Schedule 2, Schedule 3, Schedule 3-B and Securities Regulations (Determining Listing Period on Foreign Stock Exchange), 5761-2000.

list their shares for trading in Israel, on the one hand, and the aspect of protection of the interests of the investors' public in Israel, on the other.

The Minister of Finance may, pursuant to a proposal of the Authority or in consultation therewith, and with the approval of the Finance Committee of the Knesset, add additional foreign stock exchanges to those currently recognized in the rules of dual listing, should he find that the rules of the foreign stock exchange and the law applicable to corporations incorporated in Israel whose securities are listed for trading thereon, together with additional details as will be included in the listing document pursuant to the provisions of the law, adequately secure the interests of the public in Israel.[11]

Nevertheless, the Minister of Finance may, pursuant to a proposal of the Securities Authority or in consultation therewith, and with the approval of the Finance Committee of the Knesset, remove a foreign stock exchange from the list of stock exchanges recognised in the rules of dual listing, should he find that, in view of a material change, the rules or the law applicable to corporations incorporated in Israel whose securities are listed for trading thereon no longer adequately secure the interests of the investor public in Israel.[12]

Without derogating from the above, the Minister of Finance may, pursuant to a proposal of the Israeli Securities Authority or following consultation therewith, issue a directive to amend the list of foreign stock exchanges recognized in the rules of duel listing, provided that such amendment will apply to a name determined by a stock exchange, foreign stock exchange, trade lists, regulated market, or a merger or division of trade lists which a stock exchange, foreign stock exchange, or a regulated market have announced.

Furthermore, the Securities Law also enables the Authority to apply the rules of dual listing, in whole or in part, to a corporation incorporated outside Israel, whose securities are listed for trading on a foreign stock exchange and seeking to have these securities listed for trade on the Stock Exchange, provided that no mutual Recognition Agreement has been executed between the Authority and the foreign securities authority in the state in which the corporation was

11 Securities Law, s 35R. In this regard, it should be noted that in the Brodet Committee Report ('The Committee's Report for the Dual Listing of Securities'), following which the rules of dual listing were enacted, determined that the rules and the laws practised on key stock exchanges in Europe should be examined in the future and that the possibility of making further modifications to and/or concessions in the laws should be examined, to enable access for companies listed for trading to those stock exchanges also to listing for trading on the Tel Aviv Stock Exchange.

12 Securities Law, s 35S.

incorporated.[13] The Authority may make its decision contingent on conditions that it will determine.[14]

Requirements for the Offeror

Shares or securities convertible to or exercisable as shares shall not be registered for trade on the Stock Exchange unless the following conditions are fulfilled:

- With respect to a company whose shares are registered for trade for the first time — The company's share capital may consist of only one class of shares, conferring equal voting rights with respect to their par value; this condition shall not apply to special State shares, as defined in Securities Law; however, nothing in this provision shall be construed as prohibiting a company from issuing Preferred Shares (for example shares conferring a preferred right to dividends and not conferring voting rights), provided that one year has lapsed since the company's shares were first listed for trade; or
- With respect to a company whose securities are listed for trade — Any additional issue of shares will be of the shares with the most preferential voting rights; however, nothing in this provision shall be construed as prohibiting a listed company whose capital consists only of classes of shares permitted under the paragraph above from issuing Preferred Shares starting from the later of January 1, 1992, or the end of one year following the date on which its share capital consisted solely of shares as set forth above.[15]

As of August 1, 1990, a person holding foundation shares as well as capital shares in a company whose securities are registered for trade— as well as any person who purchased the foundation shares from him — will continue to hold capital shares at a rate not less than the rate he held on 1 August 1990, unless the reduction of the rate of his holdings in the capital shares derives only from rights conferred before 1 August 1990 to other holders of the company's securities to be exercised or converted into capital shares; this provision will not derogate from the application to the registered company of the provision with respect to issue of shares with the most preferential voting rights.[16]

Issue under Prospectus and Requirements Concerning Prospectus

In General

Issuing securities and offering or selling them to the public require the approval of the Minister of Finance or anyone appointed by him for that purpose; however, such approval should not be withheld unless the Minister of Finance or

13 Securities Law, s 35DD (e).
14 Securities Law, s 35DD (e).
15 Securities Law, s 46B.
16 Securities Law, s 46C.

anyone appointed by him is of the opinion that the offering, or the terms or timing thereof, contravene the government's economic policy.

Such approval may be general or for a particular class or individual. The Authority will not grant a permit to publish a prospectus unless the offering has been approved pursuant to these aforesaid provisions of Section 39 of the Securities Law.[17]

According to this Section, the officer appointed by the Minister of Finance for this purpose has granted a general permit to:[18]

- Issue and offer to the public: shares, debentures, commercial instruments options, capital notes, capital notes convertible to shares, debentures convertible to shares, and participation units in partnership (excluding bearer securities); and
- Issue bonus shares.

Securities may only be offered or sold to the public under a prospectus, the publication of which has been permitted by the Securities Authority[19] or a draft prospectus that was approved and signed according to the provisions of the Security Law[20] and filed with the Securities Authority.

It is mandatory to include in a prospectus any information that may be important to a reasonable investor considering the purchase of the securities offered thereunder, and any information stipulated by the Minister of Finance in the Regulations. It is forbidden to include in the prospectus, as well as in a draft prospectus, report, notice, document or purchase offer specification, submitted to the Authority pursuant to the Securities Law any misleading information.[21] Such prohibition applies also to an expert opinion, report, review or confirmation, which are included or mentioned in the aforesaid materials submitted to the Authority, with the prior consent of the party giving such opinion, report, review or confirmation.[22]

In an offering of securities which is not a rights' offering, it also is permitted not to include certain details with regard to the underwriter and the distributor and to change the terms of the securities offered within the period starting on the date of publication of the prospectus and ending on the commencement date for placing of orders. Such details which are not included and/or amended should be

17 Securities Law, ss 15–30 and 39.

18 *The Publications Digest* (1987), no 3476, at p 2314; *The Publications Digest* (1988), no 3525, at p 787; *The Publications Digest* (1991), no 3957, at p 1276; *The Publications Digest* (1993), no 4095, at p 2042; *The Publications Digest* (1994), no 4181, at p 1467; *The Publication Digest* (1999), no 4787, at p 4892.

19 This does not apply to certain types of offers, as further detailed hereunder.

20 Securities Law, s 22.

21 Securities Law, s 44A1 (a).

22 Securities Law, s 44A1 (b).

specified in a complementary notice to be published by the offeror.[23] Information to be included in the draft prospectus and prospectus, and requirements concerning the structure and form of the prospectus, will be specified in the Regulations enacted by the Minister of Finance, as proposed by or after consultation with the Securities Authority, and with the approval of the Knesset Finance Committee.

Restrictions on and Exemptions from Publishing a Prospectus

Until the year 2000, the Securities Authority had the authority to exempt certain offerors, including offerors that were not issuers, from publishing a prospectus.

In 2000, the Securities Law was amended and, as part of this amendment, the scope of the said exemptions was significantly expanded. This legislative expansion was performed by determining clear standards in the Law in respect of the application of the exemptions that are no longer subject to the sole discretion of the Securities Authority. Moreover, specific and detailed provisions were included with respect to additional actions which are not deemed to be an offer of securities to the public that require the publication of a prospectus.[24] Furthermore, the list of exemptions to the general rule of offering of securities to the public solely by means of a prospectus the publication of which was approved by the Authority was determined.[25]

However, such exemptions shall in certain circumstances not apply to the resale to the public of securities which were not originally offered under a prospectus.[26] In addition, a new power was granted to the Authority to exempt from the provisions of the Securities Law, fully or partially, subject to the restrictions determined in the Law, a company whose securities are listed for trading outside Israel that has offered securities to its employees or to employees of a corporation under its control, in Israel, as part of an employees' benefit plan[27]. As part of the said amendment, it was determined that the following actions would not be classified as an offer to the public, and therefore do not require a prospectus:[28]

- An offering or a sale to a number of investors not exceeding 35,[29] provided that the number of investors to whom the offeror will sell the securities in the said offer, combined with the number of investors to whom he sold securities during the 12 months preceding the said offer, will not exceed 35; for this purpose, investors who purchased shares and securities that are convertible

23 Securities Law, s 16 (a1).
24 Securities Law, s 15A.
25 Securities Law, s 15B.
26 Securities Law, s 15C.
27 Securities Law, s 15D.
28 Securities Law, s 15A.
29 Securities Regulations (Details Regarding, ss 15A–15C of the Law), 5760-2000.

into or exercisable as shares, and investors who purchased other securities, will be counted separately;

- The allocation of bonus shares that do not offer a choice to those entitled to receive them; for this purpose, 'bonus shares' are shares allocated by the company, without consideration, to all its security holders entitled to receive the bonus shares according to their proportionate holdings of the securities on the date determined for it by the company, provided that the said date is later than the date of the notice of the resolution to allocate the bonus shares;
- An allocation or transfer of securities to all or any of the security holders of a corporation by virtue of any court judgement or decree granted in a class action as defined in the Companies Law, or any allocation or transfer of securities by virtue of a decision in a proceeding under Sections 350 or 351 of the Companies Law, provided that the Securities Authority was given the opportunity to appear in the proceedings and to state its position with regard to the necessity of publishing a prospectus in order to secure the interests of the intended offerees;[30] and
- Publication of intent to sell securities to a number of offerors not exceeding 35, such offerors to be selected by a procedure determined by the entity making the publication, or to certain investors as specified below:

An offer or a sale to the following investors (deemed sophisticated investors), provided, however that prior to each date of the securities' purchase by each such investor, it shall approve in writing that it fully understands the meaning of its classification as a sophisticated investor:[31] a joint investment mutual fund as defined in the Joint Investment Trust Law, 5754-1994, or a managing company of such fund; a provident fund or its managing company as defined in the Financial Services Supervision (Provident Funds) Law, 5765-2005; an insurer as defined in the Supervision of Insurance Business Law, 5741-1981; a banking corporation and an auxiliary corporation as defined in the Banking (Licensing) Law, 5741-1981, with the exception of a joint service company, purchasing securities on its own behalf or on behalf of clients that are sophisticated investors specified in Section 15A(b) of the Law; a portfolio manager as defined

30 Following rulings of the District Court regarding the level of disclosure required from companies seeking to reach an arrangement with their bondholders with regard to modification of the terms of the bonds, the Securities Authority decided that, in this constellation, a prospectus would, indeed, not be required; on the other hand, a high level of disclosure would be required by way of detailed, immediate reporting, to be published by the company regarding the arrangement proposed by it, which would create, together with the supervision of the Court, a substitute for the publication of a prospectus. This publication obligation will also apply to a company seeking the approval of its bondholders to a modification of the bond terms, also in case it is not a part of a statutory arrangement that requires the approval of the Court as set forth in Section 350 of the Companies Law.

31 Securities Law, Sched 1.

in Section 8(b) of the Regulation of Investment Advice and Investment Portfolio Management Law, 5755-1995, purchasing for himself or for clients that are sophisticated investors specified in Section 15A(b) of the Law; an investments advisor or investments distributor, as defined in Section 7(c) of the Regulation of Investment Advice and Investment Portfolio Management Law, 5755-1995, purchasing for himself; a member of the stock exchange purchasing for itself and for clients that are sophisticated investors specified in Section 15A(b) of the Law; an underwriter that complies with the requirements of the Law, purchasing for himself; a venture capital fund, for this purpose a venture capital fund shall mean a corporation whose main business is investing in corporations which, at the date of the investment, are engaged primarily in research and development or production of innovative and high-tech products or processes, and where the risk of investment is higher than what is customary for other investments; a corporation which is wholly owned by sophisticated investors specified in Section 15A(b) of the Law; a corporation, with the exception of a corporation which was incorporated for the purpose of purchasing securities in a specific offer, whose equity exceeds NIS 50 million.

A sophisticated investor is an individual regarding whom two of the following conditions are met and who has given his prior written consent to being considered a sophisticated investor for the purpose of Section 15A(b)(1) of the Law: (1) The total value of the cash, deposits, financial assets and securities – as defined in Section 52 of the Law — owned by the individual exceeds NIS 12 million; (2) The individual has expertise and skills in the capital markets field or has been employed for at least one year in a professional position which requires capital markets expertise; (3) The individual has executed at least 30 transactions, in average, in each quarter during the four quarters preceding his consent; for this purpose, the term "transaction" will not include a transaction executed by a portfolio manager for an individual who has entered into a portfolio management agreement with him. The Minister of Finance, in consultation with the Authority and subject to the approval of the Finance Committee of the Knesset, may add to the list of investors as set forth above or may derogate from it.

Negotiations between an offeror and a party who is considering assuming an underwriting commitment, provided that the said party complies with the qualifications and requirements set forth in the Law and regulations with regard to the underwriter.[32]

A commitment to purchase securities, which is not an underwriting commitment and which was made prior to the commencement of the period for placing orders, shall be void, unless it was made by (i) any of abovementioned sophisticated investors or (ii) an investor incorporated outside Israel, provided that the Authority believes that the said investor is capable of obtaining the

32 Securities Law, s 56(c), Securities Regulations (Underwriting), 5753-1993.

information required to make a decision to invest in the securities, which would have been included in a prospectus, had a prospectus been published; provided further that: (a) the offer and sale, pursuant to a prospectus, of securities which are listed or are going to be listed for trading on a stock exchange, shall be carried out pursuant to equal terms and in a uniform manner to all. However, the Minister of Finance is authorized to determine conditions and circumstances under which all or certain of these provisions shall not apply, including with regard to certain types of offers, securities or purchasers, or with regard to securities that are being issued in an amount which is higher than an amount determined by the Minister of Finance, provided that the price of the offered securities is a uniform price as mentioned above; (b) a uniform offer shall be made without determination of a maximal price for the securities being offered; however, the Minister of Finance may stipulate in regulations that the prohibition regarding a maximal price for securities will not apply or that it will apply subject to certain conditions determined by the Minister.

In 2011 the Authority published a non-binding draft release, in which it proposed that only the following sophisticated investors managing funds for the benefit of others shall have the privilege to purchase securities under a prior commitment: (a) a fund manager who purchases securities for the funds managed by him, as these terms are defined in the Joint Investment Trust Law, 5754-1994; (b) a management company, defined in the Financial Services Supervision (Provident Funds) Law, 5765-2005, for investments made for the provident funds managed by it; (c) an insurer as defined in the Supervision of Insurance Business Law, 5741-1981, for investments held against return dependent liabilities; (d) a corporation operating outside of Israel, with characteristics similar to those of the entities mentioned hereinabove, subject to obtaining appropriate confirmations from a foreign supervisory authority of the country in which such corporation operates and from a local lawyer confirming that the said confirmation is valid as of the date of the prior commitment.

An IPO in Israel is often marketed shortly before the publication of the prospectus by way of a road show, during which the issuer, together with the underwriters/distributors, present the issuing company to institutional investors. The minimum tender price of the securities is often determined based on the responses of the potential investors. Fixing a maximum price is prohibited.

Corporations offering their securities to the public may start to market them based on a draft of prospectus made publicly available on the MAGNA reporting system,[33] prior to the final approval of the prospectus by the Authority. This relatively recent amendment is intended to modify the primary market and bring it closer to the American model, as well as facilitate the activities of foreign underwriters in Israel. Subject to certain conditions, unequal terms of

33 **MAGNA** is an acronym of the Hebrew expression which means Electronic Fair Disclosure System - the Authority's computer system used for filing with the Authority and publishing reports of reporting entities.

securities' offering shall be permitted, regarding the identity of the offerees and the quantity of the securities which are to be sold to each of the offerees, upon the underwriter's discretion, provided however that the price of the offered securities is uniform. Prior to the said amendment, issuers were faced with significant difficulties in raising capital, *inter alia*, as a result of a limitation to market the securities being issued prior to the date of final approval of prospectus by the Authority. Generally, a company and its underwriters wish to shorten the period between the approval and commencing of trade in the security as much as practically possible, in order to minimize the risk of an event that shall impede the offering, while at the same time a longer period is required in order to find investors. Similar to the American "road show model", this amendment distinguishes between the phases of offering and sale: marketing of securities and closing of orders, made by the underwriter's discretion, are permitted following the submission of a draft prospectus to the Authority; however the sale may be performed only following the publication of the final prospectus, by a uniform price.

Provision of explanations at a meeting of employees of the corporation or employees of the corporation controlled by the said corporation or controlling it, regarding the offer of securities of the corporation to such employees, so long as no information is provided regarding a reporting corporation if such information has not, as of the date of the meeting, been published in a prospectus issued by the corporation or in a report that was filed pursuant to Chapter F of the Law;[34] the following entities are also exempted from offering of securities to the public solely by means of a prospectus:

- A controlling shareholder, a general manager, or a director of the corporation whose securities are being offered, or a corporation controlled by the corporation whose securities are being offered; and
- An investor incorporated outside Israel, should the Securities Authority believe that the said investor is capable of obtaining the information required to make a decision to invest in the securities, which would have been included in a prospectus, had a prospectus been published.

In addition, the said amendment determines that the obligation of publishing a prospectus by virtue of Section 15 of the Securities Law will not apply to the following:[35]

- An offer of securities issued by a reporting corporation to its employees, including to the employees of a corporation under its control, within the framework of an employee benefit plan, by means of an outline containing the details of the offer and the offered securities as prescribed by the

34 Securities Law, s 15A(a).
35 Securities Law, s 15B.

Regulations,[36] and references to the last periodic report, to the interim financial reports, and to the immediate reports subsequently submitted, all in accordance with the Securities Law;

- An offer by the State of Israel of securities of a reporting corporation, including securities that may be converted into or exercised as securities of the said corporation issued by the State of Israel, to the employees of the said corporation, including to the employees of a corporation in its control, made in the course of privatisation not pursuant to a prospectus, by means of an outline as stated in the previous paragraph;
- An offer of securities issued by a non-reporting corporation whose securities are not listed for trade outside Israel, to its employees, including to the employees of a corporation under its control, within the framework of an employee benefit plan, provided that the consideration received for the offer and the percentage of the issued and paid-up capital of the corporation which shall be allocated to the employees pursuant to the said offer, along with those received and allocated during the year preceding the offer, do not exceed the amount determined in the Regulations (being on the date of this publication NIS 19,156,000) or 10 per cent as at the date of the offer, taking into consideration the shares that were allocated in the offer and the shares deriving from the realisation of the exercisable securities that were actually given to employees in the offer and during the year preceding the date of the offer, and without taking into consideration the shares that will derive from the realisation or conversion of convertible securities that were allocated to others by the date of the offer;[37]
- An offer of securities of a non-reporting corporation, by the State, including securities that may be converted into or exercised as securities of the said corporation that are being issued by the State, to the employees of the said corporation, including to the employees of a corporation under its control, made in the course of privatisation not pursuant to a prospectus, in respect of which the restrictions existed as set forth in the above paragraph, concerning the offer of securities issued by a reporting corporation to its employees, including to the employees of a corporation in its control, within the framework of an employee benefit plan;

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36 The Securities Regulations (Details of the Outline of a Securities Offer to Employees), 5760-2000. These Regulations refer in a partial manner to the Securities Regulations (Details, Structure and Form of the Prospectus), 5729-1969. The outline will also include any details concerning the terms of the offer and the offered securities which may be important, given the circumstances of the matter, for an employee considering purchasing the securities offered pursuant thereto, and the principles of the employee benefit plan.

37 Securities Regulations (Details Regarding, ss 15A to 15C of the Law), 5760-2000, Regulation, no 3. The consideration includes consideration in respect of the realisation or conversion of exercisable or convertible securities.

- An offer made during the course of trading on a stock exchange of securities listed thereon for trading;
- An offer by a non-reporting corporation to a number of investors even if such number exceeds 35, including the offer made jointly by the corporation and its shareholder, provided that the consideration received does not exceed the amount determined in the Regulations (being on the date of this publication NIS 2,554,000); the percentage of the issued and paid-up capital allocated does not exceed five per cent of the issued and paid-up capital of the corporation, and that the two following conditions are satisfied: the portion of the capital of the corporation allocated in the said issue, together with the portion of the capital allocated by the corporation under previous offers made not pursuant to a prospectus, does not exceed 10 per cent of the issued and paid-up share capital of the corporation on the date of the offer; and the number of investors in the said offer, together with the number of investors to whom the corporation has previously sold securities not pursuant to a prospectus, does not exceed 75;[38] and
- A listing of securities for trade on a stock exchange as a result of: a public offering of securities pursuant to a prospectus or allocation of such securities; a private placement of securities by a listed company; an offering of securities that are of the same class as those listed for trade on a stock exchange, to the public outside Israel, including the listing of securities for trade on a stock exchange outside Israel; realisation or conversion of securities into securities that were offered to the public pursuant to a prospectus or that were offered through a private placement of securities by a listed company.

Restrictions on the Resale of Securities

The legislative amendment of 2000 expanded, as stated, the scope of the exemption practised until that date. At the same time, however, it promoted the interests of the investors by imposing restrictions on the resale of securities that were allocated not pursuant to a prospectus, by means of the creation of lockup and dripping periods, as set forth below.

Securities that were offered not pursuant to a prospectus, as stated above, are subject to a lockup period before the holder may offer them for sale, in the course of trading on the stock exchange. In addition, at the end of the lockup period, the securities may be offered for sale in a gradual manner only, over a number of additional periods (dripping periods) as set forth below.[39]

The rationale at the basis of these limitations on resale is to prevent the abuse of private placements of securities, as a fast track that would enable the indirect

38 Securities Regulations (Details Regarding, ss 15A–15C of the Law), 5760-2000, Regulation, no 4. It should be noted that the consideration includes consideration in respect of the realisation or conversion of exercisable or convertible securities.

39 Securities Law, s 15C.

distribution of shares to the public bypassing the prospectus requirements. Another reason for determining a lockup period is that the neutralisation of the ability to immediately sell the securities offered not pursuant to a prospectus would force the offerees to thoroughly examine the economic viability inherent in such purchase of securities, and would thus reduce the chance of performing transactions that are ineffective, from the point of view of the capital market.

For all of these reasons, the Securities Law and the regulations by virtue thereof determine that (i) an offer to a number of investors not exceeding 35, (ii) publication of an intent to sell securities to a number of investors not exceeding 35, (iii) an offer to certain investors specified in the Securities Law[40] and (iv) an offer of securities allocated to an offeror outside Israel that was made not pursuant to a prospectus, shall be deemed an offer to the public, notwithstanding the general exemption pursuant to which these acts should not be deemed as an offer to the public, and therefore do not require a prospectus, if:

- An offer is made during the course of trading on a stock exchange of securities listed thereon for trading, during the lockup period specified below;[41] or
- The number of securities offered during each calendar quarter of the dripping period exceeds the daily average volume of trade on a stock exchange of the securities of the class offered within an eight-week period preceding the day of the offer; and (ii) The percentage of the securities offered out of the issued and paid-up capital of the corporation whose securities are being offered exceeds, as of the date of the offer, one per cent of the issued and paid-up share capital of the corporation throughout each calendar quarter. These provisions shall also apply to the offer of securities resulting from the realisation or conversion of convertible securities that were allocated to offerees as stated hereinabove. The shares deriving from the convertible securities that have not yet been exercised or converted by the date of the offer will not be included in the issued and paid-up capital of the corporation.

In addition, if made during the lockup period specified below, an offer made during the course of trading on a stock exchange of securities listed thereon for trading, which were allocated to a corporation controlled by the corporation whose securities are being offered not pursuant to a prospectus, will also be

40 Securities Law, s 15A (b).

41 In accordance with a 2012 Authority's release, sale of dormant shares acquired by a company, as well as by its subsidiary, on the Stock Exchange shall also require a prospectus; Such release also informed of the Authorities' intention to adopt amendments to Israeli law intended to allow, through the adoption of a new ATM mechanism (At The Market Offering), intending to enable Israeli public companies to issue and offer their securities to the public through the secondary market trading. For further details see "*Requirements for Offer Made by Shelf Prospectus*" below. As of the date of this publication, such new ATM mechanism has not yet been adopted.

deemed an offer to the public. The lockup and dripping periods that were determined are as follows:[42]

- With regard to an offer to a number of investors not exceeding 35, as stated above, publication of an intent to sell securities to a number of offerees not exceeding 35, as stated above, such publication or offer to sophisticated investors as specified in the Securities Law, and an offer of securities allocated to an offeree outside Israel that was made not pursuant to a prospectus, the lockup period is six months, and the dripping period is spread over six consecutive calendar quarters; and
- With regard to an offer made during the course of trading on a stock exchange of securities listed there for trading, which were allocated to a corporation controlled by the corporation whose securities are being offered not pursuant to a prospectus, the lockup period is one year, and the dripping period is spread over eight consecutive calendar quarters.

The lockup and dripping provisions will not apply to an offer made during the course of trading on a stock exchange, by the State of Israel, or by the entity that purchased securities that were offered by the State of Israel in the course of privatisation.

The last general arrangement that was included in the legislative amendment made in 2000 and related to the offer of securities to the public concerns the offer to employees of a corporation whose shares are listed for trading outside Israel. In this regard, the Authority may exempt from any or all the provisions of the Securities Law, a corporation whose shares are listed for trade outside Israel, which is not a reporting corporation, and which is offering or selling its securities to its employees or to the employees of a corporation under its control, in Israel, as part of an employees' benefit plan, if the Authority is convinced that the laws of the state where such securities are listed for trade adequately secure the interests of the employees in Israel.

Such requirement is similar to those disclosure requirements as set forth with regard to an outline regulating the offer of securities, issued by a reporting corporation to its employees as part of an employees' benefit plan, as stated above. The Authority may condition the grant of an exemption upon such terms as it will determine in order to guarantee that all the details required pursuant to the said outline are disclosed to the employees, including a translation of the offering documents into Hebrew and their submission to the employees.[43]

In addition to the foregoing, the Authority may determine, subject to the approval of the Minister of Finance, rules that will enable it to exempt an offeror from any or all of the provisions relating to the details, structure and form of a prospectus, or

42 Securities Regulations (Details Regarding, ss 15A to 15C of the Law), 5760-2000, Regulation Number 5.

43 Securities Law, s 15D.

with regard to certain types of offers, offerors, corporations, or securities, which will be published in the same manner as other laws in Israel.[44]

Required Information

In General. The Securities Regulations,[45] in addition to the general principles provided under the Securities Law, prescribe the information to be included in the prospectus and govern the structure and form thereof. The Regulations include both technical and substantive provisions. The prospectus must state whether the shares offered confer, vis-à-vis their par value, less voting rights than other of the issuer's shares. The Authority has the right to grant an exemption from all or some of the provisions of this Regulation if it deems appropriate under the circumstances.

The prospectus must include information specified in these Regulations, in so far as it is relevant to the business of the issuer and is material to its fair presentation, including all additional information which might be important for a reasonable investor considering purchase of the securities being offered; there is no obligation to indicate the absence of a particular piece of information unless expressly stipulated in these Regulations.

An issuer (excluding a corporation offering its securities to the public in Israel for the first time) may incorporate in a prospectus by reference, information it published by means of electronic reporting in an immediate report or a periodic report or a quarterly report, within the meanings ascribed thereto in the Securities Regulations (Periodic and Immediate Reports), 5730-1970, subject to certain limitations as detailed under the Prospectus Regulations.

If there is any underwriting obligation with regard to all or a part of the offered securities, information must be provided as to the name of the underwriter, the par value of the securities it undertook to purchase, the price at which it undertook to purchase the securities, the date of payment, and the commissions and other payments which the offeror undertook to pay pursuant to the agreement or in connection with the performance thereof; if the agreement applies to securities with respect to which rights have been granted, the underwriter's intention as to the securities he buys and the identity of the beneficiary who is entitled to any profits the underwriter obtains upon the sale thereof should also be specified.

If shares are offered, the issuer's capital, including the proceeds to be received for the shares, and the total delay in payment thereof, must be described; the changes that occurred in the issuer's registered, issued, and paid-up capital within three years preceding the prospectus date must be indicated, as well as the proceeds received for shares in the said period; if shares have been offered

44 Securities Law, s 15E.

45 Securities Regulations (Information in the Prospectus, Structure and Form Thereof), 1969.

under a prospectus in the said period, the date of the prospectus and the par value of the shares offered thereunder and of the shares purchased by the public must be stated; if there was any underwriting agreement during the said period, pursuant to which the underwriter undertook to purchase the shares not purchased by the public, the name of the underwriter and the par value of the shares he purchased under such agreement shall be stated.

If debentures are offered, the issuer's capital, including the proceeds payable for the shares, and the timetables for receipt of payment therefore should be described; the changes that occurred in the issuer's registered, issued, and paid-up share capital in the three years preceding the date of the prospectus must be stated, as well as proceeds obtained for shares in such period.

The shares which any principal shareholder holds in the issuer on the prospectus' date or on a date as close as possible thereto, must be stated, to the best knowledge of the issuer and its management, providing the name of each principal shareholder, the percentage it holds of any type of the issuer's securities on the said date and on a fully diluted basis, and the par value of any type of the issuer's securities which it undertook to purchase or which the issuer undertook to sell to it. If shares are offered while shares of the issuer are registered for trade on the Stock Exchange, the highest and the lowest rates of all classes of the registered shares (including the dates of such rates) in each of (i) the two financial years prior to the prospectus' date and (ii) within the period commencing at the beginning of the financial year during which the prospectus was published, and ending on the prospectus date, or a date as close as possible thereto, should be specified.

If the issuer undertook to issue, or to avoid issuing or offering securities, in general or upon certain conditions, or to refrain from receiving loans, the particulars of such undertaking must be detailed. If holders of the offered securities are granted an exemption or easement with respect to payment of taxes or under foreign currency control regulations with respect to such offered securities, the particulars of the easement or exemption must be presented, and the provisions of the law should be specified or the approval should be disclosed, as the case may be. If such exemption or easement is granted to holders of securities issued by the issuer prior to the prospectus date, and such exemption or easement is still in force, the particulars of such exemption or easement must be presented. In an offer of debentures, the deed of trust must be enclosed, and the following must be specified:

- The trustee's details, the name of the trust company, the name of the person at the trust company in charge of the debentures, and the contact details of the trustee;
- The material provisions of the deed of trust, including the procedure for amending same, the trustee's powers and authorities according to the deed of trust, the rights of the debentures' holders to accelerate payment in accordance with the deed of trust, the corporation's right to perform early redemption of

the debentures or a forced conversion of the debentures to other securities, and the terms of execution of such right;

- A description of the assets pledged and the type and class of such pledge, and to what extent, if any, has the issuer limited his authority to create additional pledges on his assets and to issue additional debentures;
- The value of the pledged assets shall be specified in the financial statements of the corporation;
- The guarantee that was given to secure the payment under the debentures and the name of the guarantor; and
- Details with respect to the debentures' provisions regarding the amendment, release, substitution, or termination of a pledge, guarantee, or other obligation given to secure the corporation's obligations pursuant to the debentures.

Any material interest which the trustee has in the issuer or the issuer in the trustee should be stated. In addition, specific details should be included in a prospectus, regarding the securities which could be used to purchase alternate securities (securities or shares purchasable in exchange for the offered securities), or regarding the shares whose rights could be altered by exercising a right attached to them. The Regulations also stipulate a special obligation to provide details of restrictions and undertakings with respect to capital dilution, if the alternate shares or the altered shares confer rights of participation in the issuer's surplus assets upon liquidation following repayment of his debts and paid-up capital.

Investment plans and other planned objectives for use of the proceeds expected from the offered securities and the amounts required for each use, shall be listed, stating separately the amount intended for working capital and the timetable required to achieve each such objective; the amounts should be determined in accordance with the prices on the prospectus date (the Regulations specify certain types of corporations that are exempted from providing such information, subject to certain conditions).

Methods of financing the amount which is missing to implement the objectives should be indicated, as well as the way the issuer will designate the proceeds if they are not received in full, subject to the obligation to return the amounts paid on account of the securities, as set forth in the Securities Law.[46] If a notice is included in the prospectus stating that the corporation reserves the right to alter the uses of the proceeds, or the amounts or the timetable required to achieve any or all of the objectives, then the terms under which the corporation is entitled to execute these rights, the corporate actions required to validate such change, and the manner in which such actions will be published in accordance with the corporation's articles should be detailed.

46 Securities Law, s 27(a).

If no minimum amount for the offer is specified in the prospectus, this must be indicated. If all or the majority of the proceeds to be received for the securities being offered are intended for investment in another company, or if any part of the proceeds is intended for investment in another company which thus becomes a subsidiary or an affiliated company of the issuer, the particulars required in these Regulations with respect to an affiliated company must be presented; with respect to a subsidiary, its most recent audited financial statements must be presented, as well.

As of 2004, these Regulations were amended as part of the ongoing trend to simplify and avail information to the investors, and the details regarding the description of the issuer were extensively expanded and formalised to unify the form and contents of a prospectus. This amendment introduced a number of new principles to be included in a prospectus, including forward-looking information, as opposed to past performance review only; certain reliefs in liability with regard to forward-looking information, under certain conditions, and a distinction between fields of activity in which a company is engaged, while giving a description with regard to each of them.

Explanations of the board of directors will be submitted regarding the state of the business of the corporation, the results of its activities, its shareholders' equity, and its cash flows, arranged in accordance with the provisions of the Securities Regulations (Immediate and Periodic Reports), 5730-1970 regarding the board of directors' report on the state of affairs of the corporation, *mutatis mutandis*, and with the exception of several provisions as set forth in the Regulations. In addition, the details regarding the exposure to market risks and their management, as stated in the Regulations of Immediate and Periodic Reports, should be submitted. The board's explanations will relate to the developments that took place in the aforesaid matters in each of the periods reflected in the financial statements presented in the prospectus, and will include a comparison between them. This provision will not apply to a banking corporation, a credit card company, or an insurer.

Pursuant to certain directives published by the Authority, certain additional information is required to be detailed as part of the board of directors' report, including the details regarding: the company's internal auditor; the company's auditor accountant's fees; the company's consent or refusal to participate in a peers' review (a review which is intended to ascertain the level of accountants in Israel and the procedures implemented during their performance of their auditing services); and critical accounting evaluation standards used by the company in its financial reports.

Certain details, regarding directors and senior officers of the issuer, as set forth in the Regulations, should be submitted. The prospectus shall contain details as to any existing agreement, undertaking, or custom, according to which the issuer pays amounts based on a proportion of its property, turnover, income, or profits.

The following information, with regard to the issuer's subsidiaries and affiliated companies shall be included in a prospectus: name of such subsidiary or

affiliated company and country of its incorporation; issuer's rights in such entity, with a distinction (if any) being made between equity rights and voting rights; securities held by the issuer in such entity, which are exercisable into equity rights or into voting rights, with differentiating between securities that are immediately convertible and those that are not immediately convertible; issuer's investment in such entity, calculated as the net sum - based on the consolidated financial reports - of the total of all assets less the total of liabilities attributable to the owner of the parent company, presented in the issuer‘s consolidated financial reports, including goodwill; if the investment is made in an entity whose securities are listed for trading on a stock exchange — the stock exchange on which such entity's securities are listed for trading and the value, according to the exchange, of the issuer‘s rights in such entity; a general description of the principal fields of business of each of the issuer’s subsidiaries and affiliated companies stating their profits, before and after provision for taxes, in the two financial years that ended prior to the date of the prospectus, and the dividend, interest, and management fee received by the issuer or which it is entitled to receive from each such company with respect to the aforesaid period, and any such payment with respect to the subsequent period; to the best of the issuer’s and its management’s knowledge, the names of holders, holding on the prospectus date or on a date as close as possible thereto, more than 25 per cent of the issued share capital or of the voting power or the authority to appoint directors in the issuer’s subsidiaries and affiliated companies, and the rate of such holdings, should be specified.

If the issuer has invested, or is going to invest, in other corporation, whether in shares or loans or otherwise, 50 per cent or more of all its assets, including the proceeds of the securities being offered, the prospectus shall include, *mutatis mutandis*, all the details that would have been required to be included in the prospectus pursuant to the Regulations if such other corporation had issued the offered securities. This provision will not apply to an issuer offering investment grade certificates of indebtedness, the proceeds of which are designated to be invested in their entirety in debentures of an investment grade banking corporation or an insurer, and the repayment of the debentures of the banking corporation or an insurer is designated to be used for the repayment of the issued certificates of indebtedness; or an issuer offering investment grade certificates of indebtedness, all of which are to be deposited in an investment grade banking corporation or insurer, where the deposit will be used for their repayment.

For this purpose, ‘certificates of indebtedness’, are certificates issued in a series by a corporation which confer the right to claim money from such corporation, on a predetermined date or upon fulfillment of a certain condition, and which do not confer the right of membership or participation in such corporation, excluding such certificates which confer on their holder the right to convert them into securities of the corporation.

The remuneration granted to certain officers and affiliates of the issuer during the two financial years preceding the date of the prospectus, and during the period commencing on the beginning of the financial year in which the

prospectus is published and ending on the date of the intermediate financial statements enclosed to the prospectus, should be specified as follows:

- Each of the top-five remuneration receivers amongst the senior office holders of the issuer or a corporation under its control, if such remuneration was granted in connection with such office holders' service in the issuer or in a corporation under its control, whether such remuneration was provided by the issuer or by another party; if a person served as a senior office holder in more than one corporation among the above-mentioned corporations, his compensation will be accumulated;
- If not listed under the above item, each of the top-three senior office holders receiving the highest remuneration from the issuer, provided such remuneration is granted in connection with their services in the issuer only; and
- A principal shareholder in the issuer, which is not listed under the above items, except for a subsidiary of the issuer, if remuneration was provided to him by the issuer or by a corporation under its control with regard to the services provided by him in the capacity of an officer of the issuer or an officer in a corporation under its control, whether an employer-employee relationship exists or not, and even in case such party of interest is not a senior office holder.

In addition the prospectus shall specify the remuneration, or obligation for remuneration, granted to anyone listed in the previous items following the date of the most recent financial statements included in the prospectus and the date of the prospectus, with regard to the publication of the prospectus.

Certain specified details must be provided, to the best of the corporation's knowledge, in relation to all transactions between the corporation and its controlling shareholder effected during the two years preceding the date of the prospectus, or still in effect on the date of the prospectus. The securities that a principal shareholder or an executive holds in the issuer, or any subsidiary or affiliated party thereof on the prospectus' date or on a date as close thereto as possible, as well as 12 months prior to the prospectus date, must be listed, to the best knowledge of the issuer and his management.

A prospectus, according to which securities of an issuer are being offered to the public for the first time, must include the issuer's annual financial statements, duly audited and prepared as of a date preceding the prospectus' date by no more than 14 months; such financial statements shall include comparative statements, as determined in the Regulations (Annual Financial Statements) - 2010. Furthermore, in certain circumstances a prospectus should include interim financial statements, including comparative figures, according to the terms and conditions set forth in the Regulations. An attorney's legal opinion shall be enclosed, confirming that the rights related to the securities being offered, as well as to other shares of the issuer or the offering party if the securities being offered are shares, have been correctly described, and that the issuer has the

authority to issue the securities being offered in the manner in which they are being offered, and that the directors of the issuer or the offering party have been duly appointed and their names are included in the prospectus. The opinion shall state that the attorney has agreed in advance to include such legal opinion in the prospectus.

The prospectus shall include the professional opinion of the issuer's auditor on the issuer's audited financial statements and the audited consolidated financial statements included in the prospectus; if the issuer is required to arrange the financial statements according to the Securities Regulations, the confirmation of the auditor shall be added. As of 1 January 2008, the International Financial Reporting Standards (IFRS) became mandatory while the earlier adoption was only voluntary. The IFRS were applied as part of the Authority's policy, intended to integrate the Israeli capital market into the global capital markets and to increase the level of transparency and reporting standards in Israel. The opinion must state that the auditor has agreed in advance to including such opinion in the prospectus. A similar opinion must be presented by the auditor of a subsidiary whose financial statements are included in the prospectus, with respect to such financial statements.

Any report, opinion, or confirmation included in the prospectus, excluding an opinion of a lawyer and of an accountant that are included in accordance with specific provisions stated hereinabove, shall include all of the following:

- A signature of the person providing the certificate, stating his name and the date thereof;
- The prior consent of the person providing the certificate for its inclusion in the prospectus;
- If a commitment was made to indemnify the person providing the certificate, this shall be stated and details of the aforesaid indemnity provided, including the identity of the person providing the indemnity; and
- Details of the facts, assumptions, calculations, and forecasts upon which the person providing the certificate relied, and of the method used for preparing the certificate, and the reasons for choosing that particular model.

If the report, opinion, or certificate does not include all or part of the aforementioned details, the issuer must include them in the prospectus. If the date of the certificate preceded the date of publication by more than 90 days, this fact shall be stated, as well as the changes that occurred after the date of the certificate that may alter the conclusions stated in the certificate and the reasons of the issuer for including it in the prospectus notwithstanding these changes. If a very material valuation was used as the basis for determination of a reported value in a prospectus, including determination that the reported value should not be amended, the corporation shall attach the said very material valuation to the prospectus.

Excluding valuations conducted by the corporation itself, the valuation should, *inter alia*, reflect the following:

- Details of the corporation's organ that decided to contract the appraiser; and
- Existence of dependence between the corporation and the appraiser.[47]

Notwithstanding the regulations regarding incorporation by reference, a corporation may include in the prospectus by way of reference very material valuations that were made public by another corporation by means of an electronic filing, even though four years or more have elapsed from the date of its publication until the date of publishing the prospectus in which the reference is made, provided that the very material valuation is presented in compliance with provision detailed above.

Valuations attached to the prospectus shall include all matters listed under the Third Schedule to the Financial Reports Regulations, as well as any other material detail which is important to a reasonable investor.

If the language of the valuation is not Hebrew, the translation of the valuation into Hebrew, including a translator's certificate confirming the accuracy of the translation and his consent to include the translation and the certificate in the prospectus, shall be included in the prospectus; valuations written in English should be included in the original language. If the effective date of the valuation (the date to which the valuation refers) precedes the publication date of the prospectus by more than 90 days, the following should be stated in the prospectus:

- The period that elapsed following the effective date until the publication date of the prospectus, specifying that this period exceeds 90 days; and
- Changes that occurred following the effective date, which may alter the conclusions of the valuation, and the company's reasons for its inclusion in the prospectus despite the changes.

The Authority is authorised to exempt a corporation from including a very material valuation, in whole or in part, if it is persuaded, following the presentation of the corporation's case, that the exemption will not harm the interests of the public.

If a material valuation or a very material valuation were used to determine the value of the items in the prospectus, including a determination that there is no need to amend the value of the said items, the following details shall be provided:

47 The corporation should state its nature and clarify why the appraiser was preferred over other independent appraisers.

- Subject of the valuation (asset, obligation, transaction, capital, activity, income, or expense, as the case may be);
- Timing of the valuation;
- The value of the subject of the valuation, determined in accordance with its valuation;
- The value of the subject of the valuation immediately prior to the date of the valuation, as it would have been were generally accepted accounting principles (including depreciation and deduction), not have required the change in value in accordance with the valuation;
- The identity of the appraiser and its expertise, including education, experience in conducting valuations for accounting purposes in reporting corporations, in similar or greater scopes as the reported valuation, the dependence on the party ordering the valuation, including reference to indemnification agreements with the appraiser;
- Valuation model applied by the appraiser for the purpose of the valuation; and
- Assumptions under which the appraiser carried out the valuation, in accordance with the valuating model, including capitalisation rate, growth rate, percentage value of discard of the total value determined in the valuation (Terminal Value), standard deviation, prices used as a basis for comparison, and the bases for comparison.

The rate of commissions paid by the issuer must be stated, along with the maximum amount it undertook to pay or which it reserved the right to pay, in connection with subscription to or underwriting or distribution of the securities; the statement shall identify the parties entitled to receive such payment, and the estimated amount of all other expenses related to the securities offering and issue. Details of commissions the issuer paid or undertook to pay during the two years preceding the prospectus' date, with respect to subscription to or underwriting of any class of securities it issued, excluding those being offered, shall be provided.

The issuer shall specify all issuances of and undertakings to issue its securities, which were executed or made for consideration that was not exclusively in cash during the two years prior to the prospectus' date, stating the consideration given or to be given.

Exemptions. The Securities Authority has the right to exempt the offeror from including certain items in the prospectus if:

- In the opinion of the Securities Authority, the preservation of an offeror's trade secret justifies the non-disclosure of the item, provided such item is not one which, had it been included in the prospectus, would have deterred a reasonable investor from purchasing the securities being offered;[48] and

48 If such exemption is granted, it must be stated in the prospectus.

- The disclosure might be detrimental to the security or economy of the State of Israel or to any investigation being conducted by the Israel Police or the Securities Authority, and the Minister of Defence, or the Minister of Finance, the Minister of Police, the Chairman of the Securities Authority, or anyone authorised by any of them for such purpose, has confirmed that such disclosure could be detrimental.[49]

The draft prospectus shall include all the information that should be included in a prospectus as aforesaid; however, it does not need to include the price of the securities being offered and their quantity. An application for exemptions from the aforesaid requirements shall be submitted to the Authority together with a draft of the prospectus, and there is no obligation to include such information in the draft prospectus. The offeror has to deliver to the Authority in writing, upon its demand, any explanations, details, information, and documents in connection with the items included in the draft prospectus, or any other matter with regard to which the Authority may require clarification. The Authority has the right to demand from the offeror that a specific item in the draft prospectus be given special prominence in the prospectus in such form as the Authority shall direct.

Required Information

The Securities Authority may require the offeror to include in the prospectus the items listed below, if it believes that under those specific circumstances such items are important to a reasonable investor considering the purchase of the securities being offered:

- Any information in addition to that presented in the draft prospectus, or additional details beyond those required under the Securities Regulations enacted under Section 17 of the Securities Law;
- Particulars required under the Securities Regulations enacted pursuant to Section 17 of the Securities Law with respect to the issuer – also with respect to its subsidiary or affiliated company;
- A legal opinion relating to items in addition to those required under the Securities Regulations enacted under Section 17(b)(3) of the Securities Law;
- An opinion by an expert with respect to an evaluation or any other matter contained in the draft prospectus or in the financial statements included therein;
- Other reports or opinions, in addition to those presented in the draft prospectus; and
- After the offeror has been given proper opportunity to present his arguments, the Authority may require financial statements, opinions, or review by the

49 If the Securities Authority finds that, from the perspective of a reasonable investor considering the purchase of the offered securities, disclosure of such information is important, it will not permit publication of the prospectus.

auditor who audited or reviewed them, or by another auditor, instead of those presented in the draft prospectus if, in the Authority's opinion, such documents were not prepared in accordance with generally accepted accounting principles and generally accepted reporting standards, and they do not fairly reflect the state of the issuer's business affairs.

Publication

The Authority will grant a permit to publish the prospectus if it is satisfied that the draft prospectus complies with the provisions of the Securities Law and the Securities Authority's requirements thereunder, and all other permits as required by law have been obtained prior to its publication.

The permit shall not constitute a verification of the details presented in the prospectus nor confirm their credibility or completeness, nor does it express an opinion on the nature of the offered securities, and all these caveats should also be stated in the prospectus itself.

The draft prospectus initially presented to the Authority and the draft prospectus pursuant to which the securities will be offered to the public will be approved by the issuer's board of directors and signed by the issuer. If the securities are not being offered by the issuer, the entity offering the securities shall sign the said drafts; at least one of the designated pricing underwriters shall sign the draft of the prospectus pursuant to which the securities will be offered to the public.

The prospectus must be signed by the issuer, as well as by a majority of the members of its board of directors, provided that at least one of them is an External Director and, in case of an initial public offering - by at least one director who is not an interested party therein, other than by virtue of being a director; a director must sign personally or by means of a person authorised by him in writing to sign the prospectus on his behalf.

If there is an underwriter for the offer, the prospectus will be signed by the underwriter as well. If the securities are not being offered by the issuer, the prospectus will be signed by the offeror as well.

The Authority has the right to delay publication of the prospectus if a director has brought to the knowledge of the Authority, by written notice stating his reasons, his objection to the publication of the prospectus or he refuses to sign the prospectus, and the Authority is of the opinion that there are grounds which would enable intervention by the court had the matter been brought before it; the delay will be for 10 days commencing on the date of the Authority's decision, unless the court directs otherwise.

A prospectus which was approved for publication must be published through electronic reporting within seven days from the approval date; the prospectus must bear its publication date. In an offer to the public, as a result of which a corporation will become a reporting corporation, the offeror must, not later than one business day following the prospectus' date, file a copy of the prospectus, a copy of its approval for publication, and of the deed of trust (if applicable) with the

Israeli Registrar of Companies and publish a notice in two widely distributed daily newspapers, published in Israel in Hebrew. Such notice shall not contain any misleading item.

Within the framework of a 2003 amendment to the Securities Law, the manual publication obligations, which prevailed until then, were replaced with electronic publication obligations. As a result, a draft prospectus and a prospectus whose publication has been permitted are to be filed according to the provisions of Chapter G1 of the Securities Law and the provisions of the Securities Regulations (Electronic Signature and Reporting), 5763-2003, enacted thereunder, under the Electronic Reporting — MAGNA.[50]

Post-Prospectus Date Actions

Subscriptions

A prospectus must specify the period for placing orders for the securities being offered thereunder, provided that such period will commence not earlier than 5 business days following the publication date, and will end no later than 45 days following the date on which it commences, with the exception of the period for placing orders for the securities offered pursuant to a shelf prospectus, as further detailed hereunder.[51] Notwithstanding the aforesaid, when securities being offered in the prospectus are commercial securities of a reporting corporation, the period for placing orders will commence not earlier than two business days following the date of the prospectus' publication. In addition, in a public offer made according to a shelf prospectus report, the period for submitting orders will commence no earlier than five trading hours following the date of the report's publication; 'trading hour' shall have the meaning ascribed to this term under the Securities Regulations (Shelf Prospectus Offer of Securities), 5765-2005. The Authority may shorten or extend these periods, provided it does not shorten them to a date prior to the publication of the prospectus, and provided it does not extend the period for longer than six months following the date on which the period commences. Offeror is prohibited from accepting orders placed before commencement or after the end of the period.

If the prospectus specifies a minimum amount which the offeror expects to obtain through the offer and the orders placed within the specified placing period do not amount to such minimum amount, the offeror shall refund the subscribers, within seven days following the expiration of the period for placing orders, any amount they paid on the securities account. If the placed orders exceed the total amount of the securities being offered, the offeror shall issue the securities in the manner stated in the prospectus, and publish a notice, within seven days following the expiration of the placing period, in at least two widely

50 *See supra* note 36.

51 Securities Regulations (Period for Submitting Orders for Securities offered according to Prospectus), 5765-2005.

distributed daily newspapers published in Israel in Hebrew, with respect to such issuance of securities; the offeror shall refund the subscribers any amount they paid on account of orders which cannot be fulfilled, within two business days following the date of issuance. Funds paid by subscribers on account of securities shall be held by the offeror in a separate trust account with a banking institution and shall be invested prudently in order to preserve the principal and to produce interest, until the offeror fulfils its obligations to refund the subscribers' amounts received by it, as aforesaid (both the principal and the accrued interest), or until it is apparent that the offeror has no such obligation. At the same time, the Minister of Finance has the right, with the approval of the Knesset Finance Committee, to stipulate in regulations the manner of investing the funds received through subscriptions and the circumstances in which there will be no requirement to refund the interest. Should the offeror not fulfil its obligations to refund the amounts received through the subscription and the offeror is a corporation, the corporation's directors, jointly and severally, will be liable to the subscribers for any amount not refunded to them, excluding a director who took all appropriate means to ensure the fulfillment of such obligations.

Foreign Corporations

In addition to the various types of relief included in the rules of dual listing for trading in Israel of securities of an Israeli corporation which are listed for trading on a stock exchange abroad (an Israeli corporation which securities are listed for trading on a stock exchange abroad, hereinafter: the 'foreign corporation'), as set forth above, various types of relief were also determined within these rules, with regard to the prospectus of a foreign corporation.

In this respect, the rules of dual listing determine that the Authority may exempt from any or all of the provisions relating to the details to be contained in the prospectus, its structure and form a corporation that was incorporated in Israel, the securities of which are being offered to the public in Israel, if securities of the said corporation are listed for trading on the following stock exchanges: NYSE, AMEX, or on the regulated market NASDAQ and NASDAQ Global Market, the NASDAQ Capital Market, or on the London Stock Exchange's Main Market (Official list of the United Kingdom Listing Authority), Primary Listing, or if they shall be listed thereupon immediately after publication of the prospectus, should the Authority deem fit to grant such an exemption under the circumstances. The Authority may condition the exemption upon certain conditions.

Trading Securities of Foreign Corporation

Listing for trading on a stock exchange of securities of a foreign corporation may be pursuant to a listing document, if the foreign corporation complies with

the preliminary threshold requirements for listing for trading under the rules of dual listing set forth above. The listing document will include two parts. The first part will include details regarding the following matters:[52]

- Details of the corporation — the name of the corporation, the fact that the corporation was incorporated in Israel and the date of incorporation, the types of securities issued by the corporation and the place where they are listed for trading, and their ticker symbol on the stock exchanges on which they are listed for trading; if the securities are partially listed for trading - the amount listed for trading of each class; the stock exchange abroad where the securities, which the corporation wishes to list for trading on the stock exchange in Israel, are listed; and the date on which they were initially listed for trading; details about the corporation, including the name and details of the person in the corporation who is responsible to maintain the contact between the corporation and the entity in charge of supervision or enforcement of the foreign law, and the name and details of the contact person in the corporation for contact with the Authority;
- Description of the shares of the corporation — the number of shares and the par value of each share, details as to whether the shares are registered or to bearer, the class of shares and the main rights attached to them, including with respect to dividend or redemption. In addition, it will be specified whether the shares entitle to participate in a distribution of full dividend or bonus shares, which will be declared after the date of the listing document and, if they do not entitle, the date of the commencement of such participation and its percentage;
- Description of convertible securities — if the securities that the corporation wishes to list for trading on the stock exchange enable the purchase of securities by way of conversion of the offered securities, the listing document shall include the following items: the securities to be issued upon conversion together with the consideration determined; the dates for submitting the conversion demand; the procedures for the conversion; and the dates on which the rights of the converted securities will expire and the rights of the securities that replace them will commence; and
- Description of bonds — If the securities that the corporation wishes to list for trading on the stock exchange are bonds or rights to purchase same, the listing document shall include the following items: the total par value of the bond series; the par value of each bond; whether the bonds are registered or to bearer; the rate of interest, the base and the terms of linkage of the principal, or the interest on the bonds (if any); the par value of the bonds in circulation, which will be re-valued in accordance with the terms of the linkage on the date of the listing document or on a date as close to it as possible (if the bonds can be re-valued under various terms, the revaluation will be made in accordance with

52 Securities Regulations (Details, Structure and Form of the Listing Document), 5761-2000.

the terms of the bonds that give the highest possible amount); the redemption dates for the bonds; the exchange rights attached to the bonds; if a guarantee was given for payment of the undertakings under the bonds, the name of the guarantor and the nature of the guarantee for the undertaking; and the name of the trustee for the bonds and the main points of the trust agreement.

The second part must include the following documents:

- The most recent annual report (termed: the 'periodic report') published or submitted by the corporation or which it was obligated to publish or submit under the foreign law, if it was already subject to such obligation;
- A document used for an offer of the securities of a corporation, published or submitted during the year preceding the year of the periodic report included in the listing document as stated above or on a date later than the date of the periodic report. A corporation whose securities were listed for trading on a foreign stock exchange and which is not yet subject to an obligation to publish or submit a periodic report will submit the document that was used for the initial offer of its securities to the public abroad;
- Any other report or notice published or submitted by the corporation or which it was required to publish or submit, under the foreign law, during the period after the publication of the periodic report or the last document as stated above by the date of the listing document; and
- Should a document included in the second part incorporate another document by way of reference, such other document will be attached.

In case of a corporation whose securities are listed for trading on the London Stock Exchange, the second part will also include the most recent prospectus used for the offering of the corporation's securities to the public, which was approved by the English securities authority, or a later report, which includes disclosures similar to those disclosed in such approved prospectus, approved by such authority. Documents originally published or submitted by the corporation in English may be included in the listing document in their original language.

Furthermore, details included in the documents published or submitted by the corporation under foreign law pursuant to the second part of the listing document do not need to be included in its first part. The listing document will include a notice that the stock exchange agreed to list for trading on it the securities underlying the listing document.

Manner of Performing the Listing for Trading

The foreign corporation will submit the listing document to the Authority, the Registrar of Companies, and the Stock Exchange, and it will publish a notice with this regard, within one business day following the date of it being submitted, in at

least two widely distributed, daily newspapers, published in Israel in Hebrew according to article 55B of the Securities Law.[53] The Authority may instruct the foreign corporation to distribute copies of the listing document in such places and in such quantities determined by it under its discretion.

The securities offered pursuant to the listing document will be listed for trading on the stock exchange on a date not prior to the third day of trading following the listing document submission date, as stated hereinabove, and not later than one month following the date of its submission.

If, during this period, the foreign corporation was required to submit reports or notices in accordance with the reporting obligations applicable to a foreign corporation (as will be set forth below), and if the offered securities were listed for trading on the stock exchange within the said period, these documents will also be submitted not later than the date of commencement of trading of the corporation's securities on the stock exchange.[54]

The foreign corporation will submit to the Authority, in writing, at its demand or at the demand of an employee so authorised, within the period that will be determined, any explanation, details, information, or documents in connection with any item included in the listing document or which is required pursuant to foreign law. The Authority or the employee so authorised by it may contact the entity in charge of supervision or enforcement of the foreign law prior to addressing such foreign corporation.[55] Should the Authority or the employee so authorised by it be convinced that the corporation was unable to submit a report or notice as stated on the date determined, they may extend the date for the submission. In this case, the provisions of the Securities Law would apply relating to an order of the Court in connection with the submission of the reports,[56] and relating to the instruction of the Authority of the cessation of trading in the securities of the corporation,[57] *mutatis mutandi*s.

Stay of Proceedings in an Action in Israel

Should an action be brought before an Israeli court pursuant to any law, in connection with the securities of a foreign corporation ("a connection with the securities " is defined in the Securities Law as ownership, holding, purchase or sale), the court may, at the request of any litigant, stay the proceedings in such action, if it is satisfied that a suit has been brought to a court outside Israel

53 Securities Law, s 35V.
54 Securities Law, s 35W.
55 Securities Law, s 35X.
56 Securities Law, s 38.
57 Securities Law, s 38A.

regarding the same or similar cause of action, until an unappealable judgment is granted in the said suit.[58]

Delisting

If, within a year of having been listed on a stock exchange, the securities of a foreign corporation have been delisted from a foreign stock exchange, the same shall also be delisted from the Stock Exchange two months after the delisting from the foreign exchange, unless the corporation has published, during the said two months, a prospectus under which the said securities shall be listed for trade on a stock exchange.

Should the securities of the corporation be de-listed from the stock exchange as stated, and should its securities be held by the public, then the foreign corporation will be subject to the periodic and immediate reporting obligations in accordance with the provisions of the Securities Law as set forth below, as long as its securities are held by the public.[59]

A foreign corporation may request that its securities which are listed for trading on the stock exchange in Israel be de-listed from the said exchange, provided that it gave notice of its intention to do so in an immediate report submitted at least three months prior to the requested delisting date, and provided that it published a notice of the requested delisting in two widely distributed, daily newspapers, published in Israel in Hebrew according to article 55B of the Securities Law, within one business day from the date of the submission of the report.[60]

A foreign corporation shall be entitled to request delisting of its securities as long as the securities of the corporation are listed for trading on a foreign stock exchange and as long as the trading of the same securities has not been suspended, or as long as the foreign stock exchange has not announced its intention to suspend the trading of or to de-list the same securities. In case of delisting due to a foreign corporation's request, any reporting obligations pursuant to the Securities Law will not apply to such foreign corporation, effective from the date of the delisting of its securities from the stock exchange in Israel.[61]

Shelf Prospectus

In General

As of 2004, an amendment was introduced to the Securities Law, as well as new regulations promulgated thereunder, intended to be a form of relief for traded

58 Securities Law, s 35Z.
59 Securities Law, s 35AA.
60 Securities Law, s 35BB.
61 Securities Law, s 35BB.

companies which are interested to raise further capital in a swifter manner than the then prevailing manner. Pursuant to this amendment, a person may offer securities in accordance with a prospectus, on several occasions, at various times ('shelf prospectus'), in accordance with the provisions of the Law and regulations.

An offer to the public of securities in accordance with a shelf prospectus can be made within 24 months of its date of publication.[62] Notwithstanding the above, an offer to the public of commercial notes (securities issued by a corporation, which are an undertaking of the corporation to pay the holder a sum of money, on a date that is not earlier than seven days from the date of the offer and is not later than a year from the aforesaid date, and which cannot be exercised for, or converted into, other securities), in accordance with a shelf prospectus that includes only the details that should be included in a prospectus for an offer of commercial papers of a reporting corporation, must be made within 12 months of the date of publication of the shelf prospectus.

If the Authority discovers, following the grant of the permit to publish a shelf prospectus, that any of the requirements determined by the Minister of Finance with regard to an offer of securities in accordance with a shelf prospectus, were not fulfilled at the time the permit was granted as aforesaid, or that they subsequently ceased to be fulfilled, the Authority may, after giving the offeror an opportunity to state its case before it, order that no further securities shall be offered under the shelf prospectus, or it may condition the continued offering of securities thereunder upon such terms as it shall stipulate. A shelf prospectus shall indicate that an offer of securities pursuant to it will be carried out according to a shelf offer report, which will detail the specific details of each offer.

The structure and essence of the Shelf Prospectus are quite similar, *mutatis mutandis*, to the ordinary Prospectus, and include chapters such as offering details, the company's share capital, the terms and conditions of the offering of the company's securities, description of the corporation's business, board of directors, interested parties, financial statements etc. In 2012 the Authority published a proposed uniform sample chapter of securities offering under a shelf prospectus, for the purpose of improving and streamlining the processing of requests for a permit to publish a prospectus. Such uniform sample is intended to be adopted by all issuers as the basis for the chapter regarding the offered securities in their prospectus, further amended to reflect the specifics of each particular offering. On the date of this publication, the said proposal has not yet been adopted under the Israeli law.

Requirements for Offer under Shelf Prospectus

The offer of securities according to a shelf prospectus is permitted, provided that the issuer is a reporting corporation (a corporation which is subject to the reporting

62 Securities Law, s 23A(B).

provisions of the Securities Law, and which has not obtained an exemption therefrom) and a 12-month period has elapsed following its previous public offer of securities pursuant to a prospectus, or, if the issuer is a foreign corporation (as defined hereinabove), to which Chapter E3 of the Securities Law applies, 12-months have elapsed from the date its securities were registered for trade outside of Israel, provided that none of the following occurs:[63]

- During the shorter of (i) a 36-month period, prior to an application for a prospectus publication permit, or (ii) the period following the date a corporation became a reporting corporation, or (iii) in the case of a foreign corporation – the period following the date on which Chapter E3 of the Securities Law has been applied to it, it came to the attention of the Authority that requirements regarding reporting obligations applicable to such corporation have not been fulfilled, all or in part or such corporation was convicted of an offence, under the Law, related to the breach of applicable reporting obligations, or a court ruled against it in connection with the aforesaid – in civil proceedings;
- During a 36-month period, prior to the publication of a prospectus, an officer of the corporation was found to have breached certain reporting obligations under the Securities Law, or has been ruled against in connection to same by a court of law in a civil proceeding; and
- If a corporation is a foreign corporation to which Chapter E3 of the Securities Law applies – during the earlier of (i) a 36-months period prior to the prospectus permit date, or (ii) within the period commencing on the date of listing for trade of its securities on a stock exchange outside of Israel, it was determined by the party in charge of enforcement of the securities law in the state where the foreign stock exchange is located and the securities of the foreign corporation are traded, that the corporation is not authorised to offer securities by means similar to a shelf prospectus.

At the beginning of 2012 the Securities Authority published a proposal to amend the Law in order to regulate the mechanism of offering securities during their trade on the Stock Exchange (‘on the floor’). The Authority proposes a new model of offering of securities to the public, in addition to existing models such as Shelf Prospectus, which is based on the U.S. “At the Market Offering” model (the “mechanism of the ATM”). According to this mechanism, companies shall be allowed to sell securities on the secondary market during trading, in quantities and prices as will be determined by them based on current market prices and demand. The goal of the proposed mechanism of ATM is to improve the market efficiency and add another effective tool for raising capital and debt. Todate, companies usually issue securities to the public through uniform proposal formats, where the price of the securities being offered is determined in

63 Securities Regulations (Requirements for Offer Made According to a Shelf Prospectus), 5765-2005.

a tender. According to the mechanism of the ATM however, there shall be no tender, but rather the company shall by itself or through a financial intermediary on its behalf, be able to offer securities directly to investors in the secondary market, during trade on the stock exchange, in quantities and at prices determined by it. According to the proposed mechanism of the ATM, the company may adopt an "ATM Plan" which would be consummated in the following manner: the company will publish a Shelf Prospectus report, and specify in it its intention to use the ATM mechanism to sell securities during trading and also specify the details of the ATM Plan. These details will include the period of the ATM Plan (not to exceed 90 days) during which the company could sell securities as well as the class and amount of securities that the company may offer under the ATM Plan. Following the publication of a Shelf Prospectus report containing the said details, the company shall be entitled to offer the securities in the course of trading on the Stock Exchange during the ATM Plan period at such sales volumes and prices as it shall determine at any time, without any prior notice to the public. The Authority also proposed certain restrictive conditions for the mechanism of ATM, which, *inter alia*, include the following: (1) publishing of a Shelf Prospectus as well as a of Shelf Prospectus report as described above, (2) obligation to enter into an agreement with an underwriter, (3) prohibition of marketing the securities thirty days prior to and within the period of the ATM Plan, (4) prohibitions on a company, its controlling shareholder and insiders, as defined in the Law, from effecting any transaction in the securities, (5) transactions under the ATM Plan are permitted during the course of trading on the Stock Exchange only, (6) demand for filing of an immediate report on each day of sales pursuant to the ATM Plan; (7) limitations of daily volume of sales etc. As of the date of this publication, such new ATM mechanism has not yet been adopted.

Shelf Offer Report

If the offeror wishes to offer securities in accordance with a shelf prospectus, it shall submit to the Authority a report concerning the offer ('shelf offer report'); this provision will not apply to an offer of securities in accordance with a shelf prospectus if all of its details, including the period for placing orders thereunder, were determined in the shelf prospectus on its date of publication.

A shelf offer report shall be submitted not later than five trading hours prior to the commencement date for placing orders and it shall be deemed published immediately with its submission. A shelf offer report shall include any material change or new detail that occurred regarding any matter, which has to be described in a shelf prospectus, and the offeror may incorporate such information by way of reference. In addition, the shelf offer report shall include the following details, if relevant to the offer:

- The securities being offered and their percentage out of the voting rights and out of the issued and paid share capital post issuance, as well as on a fully diluted basis;
- The amount of securities offered;

- The interest rate and index rate terms that the securities being offered will bear;
- The date of execution or conversion of the securities being offered;
- The price of the securities and the conditions of payment; and
- The period for placing orders.

A shelf offer report shall be deemed a prospectus, and the statements in the report shall be deemed, as of the date of its publication, an integral part of the shelf prospectus. Notwithstanding the above, the publication of a shelf offer report does not require a permit from the Authority under the Securities Law.

Registration for Trade

In General

Any registration for trade is subject to the approval of the Board of Directors of the Stock Exchange as stipulated in the Regulations and, *inter alia*, fulfilling the following conditions:

- All shares in the issued share capital of the company must be fully paid;
- The company's documents of incorporation may not limit the transferability of the securities listed for trade;
- There must be appropriate dispersal of the securities, whether with respect to public holdings or with respect to the breakdown of holdings, all as stipulated in the directives of the Board of Directors of the Stock Exchange;
- The company's articles of association must specify that voting at the general meetings will be by way of counting votes; and
- The company must undertake to comply with the Stock Exchange's Regulations and the Stock Exchange Board of Directors' directives thereunder, as amended from time to time and to the extent they relate to registered companies.[64]

The offeror of securities to the public may increase the amount offered to the public in a scope that will not exceed the proportion determined in the directives (termed: the 'additional amount'), when the demand for the securities at the price that was determined in a tender exceeds the amount offered in the tender, provided that the following conditions are satisfied:

- The additional amount will be issued at the price determined in the tender;
- The potential for increasing the amount being offered to the public, and the conditions under which the amount would be increased were specified in the prospectus;

64 Stock Exchange Regulations, ss 63A–69.

- The additional amount will be of units of a composition identical to that offered to the public in the tender; and
- The additional amount will be issued to offerees that submitted applications for the purchase of securities in the tender at the price determined in the tender or at a price higher than the price determined in the tender.

The additional amount will not be included in the determination of the price, even if it is necessary to determine a price that is lower than that determined in the tender, for the purpose of achieving a minimum spread.[65] The Stock Exchange Board of Directors has the right to stipulate in the directives additional terms for registration for trade, relating to the following issues:

- The number of classes or series of convertible securities registered for trade per company;
- Lock-up of securities held by a shareholder or type of shareholders for a period and at a percentage to be determined, provided the period shall not exceed three years following the date of registration for trade;
- Regulation of trading for a limited period, including immediately following the registration for trade, as stipulated in the directives;
- Registration for trade in various commercial groups and various trading methods;
- Limiting the quantity of subscriptions to securities registered for trade, or to issue units including various types of securities, restricting the percentage of the subscriptions or restricting the allocation per subscriber; and
- The period within which the subscription funds may be deposited.

The Board of Directors of the Stock Exchange may approve the listing for trading of securities in respect of which rules of listing were not determined pursuant to the Stock Exchange rules, provided that the terms of the said securities are similar to those of the securities in respect of which rules for listing for trading were determined. Such approval is subject to compliance of the securities whose listing is requested with the conditions set forth in the Stock Exchange rules for securities that are similar to them, *mutatis mutan*dis, as the Board of Directors will determine.

The Stock Exchange Board of Directors has the right, in special circumstances, not to approve registration for trade, or to condition the registration, even if all requirements under the Regulations have been fulfilled, provided that such decision is adopted by a majority of at least 75 per cent of the members of the Stock Exchange Board of Directors participating in the meeting, and provided that the company has been given due opportunity to present its position to the Board of Directors in writing.

65 Securities Law Regulations (offer of securities to the public), 2007.

Registration for Trade of Securities of Companies whose Shares Are Not Registered for Trade

In General

As mentioned above, the share capital of the company shall consist of one class of shares only, conferring equal voting rights with respect to par value excluding special State shares.[66] Nothing in this provision shall be construed as prohibiting a company from issuing preference shares, provided that one year has lapsed since the shares were first listed for trade.

All shares of a new company's share capital shall be registered for trade, excluding a company to which the Law of Encouragement of Industry (Taxes), 1969, applies and a company whose share capital includes special shares of the State of Israel, subject to limitations stipulated in the Stock Exchange directives.[67] A new company whose most recent financial statements included in its application are annual statements or interim three-month statements, shall comply with all or certain of the following conditions, as specified in the directives, as follows:

- The company must have completed certain periods of activity, as specified in the directives, in the field of business in which it is engaged, and in which it has stated that it intends to continue to engage following its registration for trade;
- The extent of the activity and equity capital prior to registration for trade shall not be less than the amounts specified in the directives;[68] and
- The equity capital following registration for trade shall not be less than the amount specified in the directives.

A new company that desires to register shares for trade, whose most recent financial statements included in the application are interim statements for six or nine months, must comply with the aforesaid conditions, subject to limitations to be stipulated in the directives.

The value and percentage of the public's holdings shall not be less than those specified in the directives. The ratio between options of any class and shares offered to the public shall not be less than the ratio between options of such class and shares issued before registration for trade.

66 Securities Law, s 46b.
67 Stock Exchange Regulations, ch J.
68 The Stock Exchange Regulations stipulate for that purpose a number of rules according to which the income, expenditures, profits, and added value will be calculated.

Further Conditions

The Stock Exchange Board of Directors may stipulate in the directives additional conditions for registering a new company for trade, in general or for each series separately, as to the following:

- Specification of classes of securities that may be registered for trade;
- Overall minimum value at the time of registration;
- The minimum share that will be held by the public and the dispersal rate thereof immediately following the registration;
- The percentage of public holdings immediately following the registration for trade if shares are registered for trade together with convertible securities; and
- The maximum number of classes or series.

Various rules may be stipulated in relation to the above, taking into account the characteristics of the company, the extent of the offering, and the classes of securities registered for trade.

The condition precedent for the listing of a new company spun off from a listed company, as part of a spin-off process, is that the percentage of public holdings in the listed company and the value of the public holdings in the listed company following the spin-off will not be less than those set forth in the directives.

The abovementioned rules also apply, subject to modifications to be stipulated in the directives, to registration for trade of a foreign company and of a company whose securities are registered for trade or are traded outside Israel.

Registration for Trade of Securities of Companies Whose Shares Are Registered for Trade

In General

As mentioned above, any additional share offering to the public following the initial offering must be made of shares with the most preferential voting rights.[69] The ratio between options of all kinds and shares offered to the public shall not be less than the ratio between options of such class and the shares issued before registration for trade.[70]

The Stock Exchange Board of Directors has the right to stipulate in the directives additional conditions for registration for trade of the shares of a registered company, in general or for each series separately, as follows:

- Specifications of classes of securities that may be registered for trade;
- The overall minimum value at the time of registration;

69 Securities Law, s 46B.
70 Stock Exchange Regulations, ch K.

- The minimum share that will be held by the public and the dispersal rate thereof immediately following the registration;
- The percentage of public holdings immediately following the registration for trade if shares are registered for trade together with convertible securities; and
- The maximum number of classes or series.

Various rules may be stipulated in this respect, taking into account the characteristics of the company, the extent of the offering, and the classes of securities registered for trade.

A registered company whose share capital consists of only one class of shares may issue only shares of the class registered for trade; should the registered company have various classes of shares, whether all of them or only a part thereof are registered for trade, any additional issuance shall be of the shares conferring the most preferential voting rights.

A registered company shall not issue shares or convertible securities unless the Stock Exchange Board of Directors approves that the shares or the security derived from the conversion may be registered for trade. The value and percentage of the public's holdings shall not be less than those stipulated in the directives.

Other Requirements

Shares and convertible securities of a registered company which are not registered for trade shall not be registered for trade and shall not be traded outside Israel, unless approval is granted by the Stock Exchange Board of Directors according to rules to be stipulated in the directives.

The offer by way of rights shall be of a type of shares permitted to be offered to the public, as provided above, and registered for trade, or of a convertible security which must be of a type permitted to be offered to the public and is registered for trade.

The Stock Exchange Board of Directors has the right to stipulate directives with respect to the method of calculating of the bonus component, timetable for the offering, trade of rights, manner of utilising the rights, and the trade in the securities registered for trade when the rights are offered.

To the extent it is required for proper trading procedures, or proper management of the Stock Exchange, the Stock Exchange Board of Directors has the right to condition the registration for trade of shares or convertible securities, offered by way of rights, upon including same also in a public offering.

Private Offering of Securities of Listed Company

Both under the Companies Law and under the Securities Regulations, legislative arrangements have been determined regulating a private offering of securities of a public company or of a listed company, as will be reviewed below.

Substantial Private Offering — Companies Law

Special Approval for Substantial Private Offering. The Companies Law incorporates a special arrangement concerning a substantial private offering as defined below, within the section contemplating transactions with interested parties.[71]

The following private placements must be deemed a substantial private offering, provided that the transaction does not harm the best interests of the company, and shall be subject to the approval of the board of directors and the general meeting of shareholders:

- An offering which provides 20 per cent or more of the total effective voting rights in the company before the issuance, provided that all or part of proceeds of such offering are not in cash or in securities listed for trading on the stock exchange or are not at market conditions, and as a result of which, the holdings of a principal shareholder (a person holding five per cent or more of the company's issued share capital or the voting rights in the company) in the company's securities will increase, or as a result of which a person shall become a company's principal shareholder following the issuance ('interested party').
- An offering as a result of which a person shall become a controlling shareholder of the company (a person with the ability to direct the company's activity, except for an ability deriving solely from acting as a director or an officer of the company. A person shall be deemed to be a controlling shareholder of a company if he holds half or more of a certain type of means of control of the company, as well as a person holding 25 per cent or more of the voting rights in the general meeting of the company's shareholders if there is no other person that holds more than 50 per cent of the voting rights in the company).

For this purpose, all private offerings conforming to one or more of the following requirements, shall be deemed a single private offering:

- They were made during a period of 12 consecutive months to the same offeree or anyone on its behalf, its relative, a corporation under its control or its relative's control and, if the offeree is a corporation – also to the controlling shareholders of the offeree, to the relative of the controlling shareholder and to a corporation under the control of the controlling shareholder or its relative;
- They were made during a period of 12 consecutive months, and in all of them consideration was determined in the same asset. For this purpose, different securities of one company shall be deemed as the same asset; or
- They constitute part of one transaction or they are conditional upon one another.

71 Companies Law, 5759-1999, ss 268–284.

For the purpose of determining market conditions, as set forth above, an offering shall be deemed reflecting market conditions if the board of directors resolved, based on detailed reasons, that the offer is at market conditions, unless proven otherwise. For the purpose of holdings, as set forth above, securities convertible or exercisable into shares, which are held by a person or which will be issued to a person pursuant to a private offering shall be deemed converted or exercised.

Special Exemption. The regulations granting relief to companies whose securities are listed for trading on a stock exchange outside Israel[72] provide a special exemption, under which the approvals required for a substantial private offering, will not apply to a public company whose shares have been offered only to the public outside Israel or which are listed for trading only on a stock exchange outside Israel.

Private Offering of Securities in Listed Company. Regulations of a private offering of securities in a listed company[73] which were enacted in 2000 deal with all requirements, various acts, and reporting aspects required in respect of a private offering of securities in a listed company, while categorically distinguishing between an exceptional private offering and a substantial private offering as specified below.

Private Offering and Exceptional Private Offering. A private offering is an offering to issue securities of a listed company other than a public offering. The total of all of the private offerings satisfying either of the following will be deemed one private offering:

- They were made during a period of 12 consecutive months, and they satisfy one of the following: (i) the offerings are to the same offeree or to someone on his behalf, his relative, a corporation controlled by him, or controlled by his relative; when the offeree is a corporation — also to the controlling shareholder of the offeree, a relative of the controlling shareholder, or a corporation controlled by the controlling shareholder or controlled by his relative; or (ii) they stipulate consideration in rights in the same asset and different securities of one corporation will be deemed the same asset; or
- They constitute part of a single transaction or they are conditional upon one another.

An exceptional private offering is:

- A private offering of securities that grants 20 per cent or more of the total of all the actual voting rights in the company before the offering; for this purpose, securities that may be converted into, or exercised for, shares that

72 The Companies Regulations (Relief to Companies Whose Securities Are Listed for Trading Outside Israel), 5760-2000.

73 Securities Regulations (Private Offering of Securities in a Listed Company), 5760-2001.

will be issued under the private offering will be deemed to have been converted or exercised; or

- A private offering to: (i) a director or general manager or to a person who will become a controlling shareholder subsequent to the offering, which grants 20 per cent or more of the effective voting rights in the company prior to the issuance, the proceeds of which, in part or in whole, are not in cash or in securities listed for trading on the stock exchange or which are not at market terms, and as a result of which (i) the holdings of a principal shareholder (as defined hereinabove) will increase or (ii) a person will become a principal shareholder following the issuance.

Approval of Listing for Trading. A private offering of securities of a listed company requires the approval of a stock exchange in Israel, in accordance with its rules, to list for trading the securities that will be issued under such offering or securities deriving from the conversion or exercise of the securities that will be issued thereunder.

Notice of Exceptional Private Offering. If the board of directors of a listed company resolves to effect an exceptional private offering, the company will give notice, within 14 days following such resolution, specifying its details and the convening of a general meeting, if one is required for approving the offering, by the following three methods:

- Filing an immediate report concerning the transaction (in this section, termed: the 'offering report', or 'report'), as specified below;
- Publication of a notice incorporating certain pre-defined details, in at least two widely distributed daily newspapers published in Israel in Hebrew (the company may publish the notice in any additional manner as it finds fit, including via the Internet and is also required to include information of convening the general meeting on its web-site, if any), on the date of filing the transaction report or on the next business day.
- Forwarding the transaction report by registered mail to a shareholder who is entitled to vote at the general meeting, at his request.

If the offering constitutes an event or a matter deviating from the ordinary course of business of the corporation, by virtue of its nature, scope, or likely outcome, and which has or is likely to have a substantial impact on the corporation, or which is likely to substantially affect the price of the corporation's securities, an immediate report will also be submitted in accordance with the Periodic and Immediate Reports Regulations,[74] as specified below.

Offering Report. The offering report will include any and all details relating to the offering and likely to be of significance to a reasonable investor or a

74 Securities Regulations (Periodic and Immediate Reports), 5730-1970, reg. 36.

reasonable shareholder for the purpose of voting at the general meeting, including:

- Name of offeree; if the offeree is a corporation and an interested party — its name and a breakdown of holdings of the controlling shareholder in the offeree;
- If the offeree is an interested party, specification of the facts by virtue of which he is an interested party;
- The terms of the securities proposed to be issued, the number thereof, and the proportion in percentage which they will constitute of the voting rights and of the issued and paid-up share capital of the company after the issuance as well as on a fully diluted basis;
- The fair value of the securities convertible or exercisable into shares, stating the manner and the formula for determining the fair value and the assumptions serving as the basis thereof;
- If the offering is part of a transaction, the transaction will be described; in the event the offeree is an office holder or an interested party and the offering is made as part of his reward, the offering report shall include the details specified in the Sixth Supplement to the Periodic and Immediate Reports Regulations, in addition to those specified in the Private Offering Regulations;
- The company's issued share capital, the amount and the percentage of the offeree's and of company's interested parties' holdings and the total holdings of the other shareholders in the company's issued and paid-up share capital and voting rights, as follows: prior to the issuance; following the issuance; in the event of convertible securities — following the issuance and assuming that the offeree will convert and exercise the securities issued to him under the offering; following the issuance, assuming that all existing and offered securities exercisable or convertible into company's shares will be converted and exercised;
- The consideration for the securities being offered, according to the specification required below (consideration in cash, consideration by waiver of liability, consideration by securities or whole or a substantial part of a corporation's activity, consideration in the form of a corporation's activity which does not amount to the substantial activity of such corporation, consideration in several assets, or consideration in another asset — all as specified below);
- The manner in which the consideration has been determined;
- The name of every principal shareholder or officer in the company who has, to the best knowledge of the company, a personal interest in the consideration, and the nature of his personal interest;
- If the securities being offered are shares — the average price of share during the six months preceding the date of publishing the offering report will be specified, taking into account any distribution, split, or issue of rights, and the share's price immediately before the resolution of the board of directors

concerning the offering as well as immediately before publication of the report; If they are option warrants — the price of the option warrant will be specified if option warrants of the same series are listed for trading on the stock exchange, and the share's price, immediately before the board of directors' resolution concerning the offering as well as immediately prior to publication of the report; If they are bonds convertible into shares — the average price of the bonds during the three months preceding the date of publishing the offering report will be specified, and if bonds of the same series are listed for trading on the stock exchange, the prices of the bond and the share immediately before the board of directors' resolution concerning the offering as well as immediately before publishing the report; and if securities of the same series are listed for trading on the Stock Exchange — the proportion in percents between the price of the securities being offered and the stock exchange price of securities of the same series immediately before publishing the report will be specified;

- A breakdown of the investment plans and other designated use of proceeds of the offered securities, when the consideration is in cash; the company's plans in respect of the acquired asset will be specified where the consideration is not in cash;
- A breakdown of written and verbal agreements, between the offerees and shareholders in the company or between all or any of the offerees, between themselves or between them and others, concerning the purchase or sale of securities of the listed company or in respect of voting rights therein, to the best knowledge of the company, following examination it has conducted in this respect with the offerees and specifying the inspections it has conducted;
- Required approvals or conditions determined for the implementation of the issuance under the offering; whether such approvals or conditions were accepted or satisfied and, if not, the date, on which they are expected to be accepted or implemented;
- Specification of a limitation or restriction on performing actions with the securities being offered, which are applicable to the offeree pursuant to the regulations of a stock exchange in Israel, under any law or pursuant to an undertaking assumed by the offeree, to the best knowledge of the company;
- The board of directors' grounds for the approval of the private offering, the value determined for the securities being offered, and the value of the consideration for such securities, as well as the names of the directors who took part in the discussion of the board of directors concerning the approval of the offering, indicating those of them who are external directors of the company;
- The date of issuance of the securities;
- Venue for convening the general meeting, if required, the date for the meeting, the required majority for such meeting, the date for determining the entitlement of the shareholders to vote at the general meeting, and the number of shares constituting the proportion of the total voting rights, if determined,

in the regulations promulgated pursuant to Section 89(3) of the Companies Law or the value of shares if determined in the said regulations;

- If the company has determined that an adjourned meeting will take place on a date later than one week following the date of convening the first meeting, such date will be stated;
- The fact that instructions given by the Authority or by an employee authorised by it, to provide explanations, details, information, and documents relating to the offering underlying the report, or instructions to amend the report in such manner and on such date as designated by the Authority, may delay the convening of the general meeting; and
- Details of the company's representative to attend to the report, including his office address and telephone and facsimile numbers.

A form of the voting card, as defined in the Companies Law[75] will be enclosed to the offering report. The report shall be signed by the company, specifying the names of the undersigned and their title. The cover of the report will designate, *inter alia*, the following details: the company's name, the offeree's name, in the event that the offeree is an interested party, the facts by virtue of which he is an interested party.

Newspaper Publication. As of 2008, following enactment of the Securities Regulations (Publication of Newspaper Notices) 2008, the requirement for certain details, to be included in a newspaper publication, was changed to include materially less details. The said requirement was replaced by reference to the electronic report published by the corporation on the same matter, which enables to receive additional information with respect to the subject matter. These Regulations require that only the following details shall be provided:

- The name of the reporting entity;
- The type of the reported event;
- Reference to an electronic report which enables to receive additional information with respect to the subject matter; and
- Important dates which are essential to the investor, if any, including the dates of a shareholders' meeting convened for purpose of approval of the subject matter or the dates of approval of a purchase offer.

Perusal and Forwarding of Documents. The company will make available to a shareholder, at his request, at such place as it will designate and subject to the provisions of any law, a copy of any document relating to an exceptional private offering, including the documents presented to the board of directors within the procedures of discussion and adoption of a resolution in this regard.

75 Companies Law, s 75.

The company will transfer to a shareholder, at his request, and subject to the provisions of any law, a copy of the said documents as well as a copy of the offering report and may charge him with reasonable costs in respect of photocopying and transfer.

Consideration in Cash. In the event that all or any part of the consideration for the securities being offered under an exceptional private offering is in cash, the report will specify the sum, the dates of payment and the terms of payment that are determined; if the company or an interested party therein has granted the offeree, whether directly or indirectly, a loan for the purchase of the securities being offered, the report will specify the details of the loan, including due dates, securities, and terms of linkage and interest.

Consideration by Waiver of Liability. In the event that all or any part of the consideration for the securities being offered under an exceptional private offering is by waiver of liability, the details of the liability and the waiver will be described in the report.

Consideration in Securities or in Corporation's Activities. In the event that all or any part of the consideration for the securities being offered under an exceptional private offering is in the form of a corporation's securities or the transfer of all or a substantial part of the activities of a corporation (termed: the 'corporation'), the report shall include:

- The description of the corporation in respect of the period commencing two years prior to January 1st of the year in which the report is submitted and ending immediately before the date of the report or the amended report, as the case may be, in accordance with the breakdown specified in the outline, to the extent that any matter specified in the report involves the corporation and is material for the corporation's activities or operations;
- Financial statements as stated in the paragraph below will be enclosed to the report; and
- Explanations of the offering company's board of directors to the enclosed financial statements, in accordance with the outline.

Financial Statements. The corporation's financial statements, to be enclosed to the offering report (termed: the 'financial statements'), shall include the details as required by the applicable Regulations with regard to financial statements included in a prospectus,[76] *mutatis mutandis*, and the following shall apply:

- Annual and interim financial statements will be prepared in accordance with generally accepted accounting principles and shall also include disclosure provisions set forth in the Financial Statements Regulations and Periodic and Immediate Reports Regulations, as the case may be;

76 Securities Law Regulations (Details, Structure and Form of Prospectus and Draft Prospectus), 1969, sec 56.

- The financial statements shall be audited or reviewed, as the case may be;
- A report of the accounting auditor or the review report, as the case may be, will be incorporated in the offering report, and will state that the two abovementioned conditions are met, and that the person that prepared such statements or report has given his prior approval for the inclusion of this information in the report;
- In the event that the language of the financial statements (including the auditing or the review reports) is not Hebrew, a translation of the reports into Hebrew and the translator's confirmation in respect of the accuracy of the translation and his consent to the inclusion of the translation and confirmation in the report should be included in the report; and
- In the event that the currency of the financial statements is not NIS, and such currency is not exempted in accordance with the Financial Statements Regulations, a convenience translation of the stated sums into NIS should be included, prepared in accordance with generally accepted accounting principles.

A Corporation Whose Securities Are Listed for Trading. In the event that the securities of the corporation are listed for trading on the Stock Exchange and the corporation reports pursuant to Section 36 of the Securities Law (as specified below), and no exemption from reporting was granted to the corporation, the company will be deemed to have complied with the requirements as to the inclusion of the information and documents in the offering report listed in the previous two paragraphs (consideration in a corporation's securities or all or a substantial part of its operations and financial statements), if it includes in the transaction report the corporation's periodic report for the last year that has ended prior to the date of publication of the transaction report, as well as its last interim report, published after the date of such periodic report, provided that any significant change that occurred in the corporation's business in any matter which should be described in the periodic report, until the date of the transaction report, will be specified. The inclusion can be by way of incorporation by reference.[77]

Consideration by Means of Insignificant Corporation's Activity

In the event that the consideration for the securities being offered under all or any part of an exceptional private offering is the transfer of the corporation's activity not amounting to the substantial activity of the corporation:

- The report will include a description of the said corporation's activity as set out in the outline presented below, to the extent that any issue detailed in the report relates to the corporation and is material to the corporation's affairs or activity;

77 Securities Regulations (Periodic and Immediate Statements), 5730-1970, s 5A.

- The description will be provided in respect of the period commencing two years before January 1st of the year in which the transaction report is submitted and ending immediately prior to the date of the transaction report or the amended transaction report, as the case may be;
- The description will only refer to data from financial statements prepared according to Israeli or International generally accepted accounting principles, audited or reviewed, as the case may be, with respect to which an unqualified opinion has been given;
- The financial statements will incorporate a note as to the accounting policy and will state the principles according to which they have been prepared; the name of the auditor who signed the auditor's report will be stated and the auditor will state that he provided an unconditional opinion and has agreed to the reference to the auditor's report in the transaction report; and
- If the transferred activity is a sector or a number of sectors of the corporation's financial statements, the transaction report will incorporate, in addition, the data from the corporation's Financial Statements relating to such sector or number of sectors (The term "sector" shall mean operating sector as defined in the generally accepted accounting principles).

Consideration by Several Assets. If the consideration for the securities being offered comprises several assets, then certain reporting requirements specified above (regarding (i) consideration made in securities or all or a substantial part of a corporation's activity, (ii) financial statements, (iii) report by a corporation whose securities are listed for trading on a stock exchange in Israel, and (iv) consideration by means of insignificant corporation activity) will not apply in respect of any of the assets offered as consideration, if the company's board of directors considers that the securities issued in consideration for such asset reflect less than five per cent of the voting rights in the company. In such event, the calculations made by the board of directors and the assumptions on which it relied will be specified in the report.

Consideration in Another Asset. If all or any part of the consideration for the securities being offered is an asset other than securities or all or a substantial part of the activity of a corporation, or insignificant activity of the corporation, the report will include a description of the asset, including the rights and liabilities related to the asset or involved in the transfer of such asset, and shall comply with the requirements specified in the Periodic and Immediate Reports Regulations with regard to purchase of assets.

Professional Opinion. If the value of the consideration in an exceptional private offering is also based on a professional opinion, the opinion will be incorporated in the report. *Inter alia*, the opinion will contain certain details specified in the Periodic and Immediate Reports Regulations with regard to value assessment.

If the date of the value determination opinion precedes the date of the approval of the offering by the company's board of directors by more than 90 days, the following details will be stated in the transaction report: the fact that the board

of directors has relied on an opinion whose effective date is 90 days prior to the date of approval of the offering by the board of directors; the period lapsed from the effective date thereof until the approval date; the changes that took place after the effective date which are likely to change the value of the asset as determined in the opinion and the grounds of the board of directors for reliance on the opinion notwithstanding such changes.

If the effective date of the opinion precedes the date of convening the general meeting by more than 90 days, the changes in the asset commencing on the effective date up to the date of submitting the offering report or the amended offering report, as the case may be, should be specified.

Instruction by Authority. The Securities Authority or an employee authorized by it to this end may, within 21 days following the date of submission of the offering report, instruct the company to provide, within the designated period of time, an explanation, specification, information, and documents pertaining to the offering forming the subject matter of the report, and it may further instruct the company to amend the report in such manner and on such a date as will be designated by it.

In the event that the Authority has instructed to amend the report, the Authority may also instruct to postpone the date of the general meeting to a date within a period commencing three (3) business days and ending thirty five (35) days following the date of publishing of the amended offering report. In the event that the Authority instructed a company as specified above, the company will announce such instruction in an immediate report.

Unless otherwise instructed by the Authority, the company will file an amendment made in accordance with the instruction through an amended immediate offering report, which will be circulated to all shareholders to whom the original offering report has been circulated, and will publish a notice in a manner specified in the Securities Regulations (Publication of Newspaper Notices) 2008. In the event that instructions concerning the postponement of the general meeting were given, it shall be reported in an immediate report.

If 21 days have elapsed following the date of the report submission and no instructions have been given by the Authority, the company may issue the securities pursuant to the offering, provided all other conditions relating to this matter and stipulated in the Private Offering Regulations and in any applicable law have been met.

A corporation is entitled to amend any details presented in the offering report, subject to the applicable provisions of the Offering Report Regulations. Any amendment thereto shall, *inter alia*, be released to the public in an immediate report.

Depositing Offering Report with Authority. A listed company may deposit with the Authority, within 14 days following the date of approval of the transaction by the board of directors, a preliminary offering report which will include all the details to be set forth in an offering report as aforesaid, being

signed by the company and designating the signatories' names and their position with the company. The right of the Authority to receive clarifications, specifications, information, and documents and to request amendment of the report and postponement of the general meeting will apply to such preliminary report, *mutatis mutandis*.

On the date of filing of the preliminary report, the company will submit an immediate report, describing the principles of the board of directors' resolution regarding the offering (the 'summary report'). If applicable, in the summary report the company will state that it is about to submit an offering report for the approval of an exceptional private offering at the general meeting and designate the date of the general meeting.

If the company is instructed to amend the preliminary report, the company will submit an amended report in accordance with the Authority's instructions and will give notice of convening a general meeting for the approval of the offering, if such meeting is required.

In the event that 21 days have elapsed from the date of deposit the preliminary report, and the Authority has not contacted the company with instructions to amend the preliminary report, the company will submit the report in the manner offering reports are submitted. Such submitted report shall also be subject to the Authority's amendments during a period of 21 days following the submission, all as specified hereinabove. If the preliminary report is updated or revised, the listed company will notify the Authority of the changes it has introduced.

Substantial and Insubstantial Private Offering

Definition of Substantial Private Offering. A substantial private offering is one of the following private offerings:

- A private offering to a principal shareholder[78] or private offering representing five per cent or more of the total effective voting rights in the company before the offering, provided it is not an exceptional private offering. In this context, securities convertible or exercisable into shares, to be issued under such private offering, will be deemed to have been converted or exercised; or
- A private offering to a director or a general manager other than an exceptional private offering.

Substantial Private Offering. If the board of directors of a listed company resolved upon a substantial private offering, the company will publish an immediate report, within seven days following the date of the resolution; the immediate report will specify all details concerning the substantial private

78 A shareholder holding five per cent or more of the company's issued share capital or the voting rights in such company, or a person who will become such a shareholder following the issuance of the securities.

offering likely to be important for a reasonable investor or a reasonable shareholder, including, *inter alia*:

- Name of offeree; if offeree is a corporation and an interested party - name and holdings of the controlling shareholder in the offeree;
- If the offeree is an interested party, specification of the facts by virtue of which he is an interested party;
- The terms of the securities proposed to be issued, the number of securities, and their percentage in the voting rights and the issued and paid-up share capital of the company following the issuance as well as on a fully diluted basis;
- If securities of the series being offered are listed for trading on the Stock Exchange: the price of the securities being offered and the price of securities of the same series on the Stock Exchange on the day preceding the publication of the immediate report, as well as the percentage proportion between them;
- The fair value of the securities convertible or exercisable into shares, stating the calculation formula and assumptions serving as the basis for such calculation;
- If the offering is part of a transaction, the principles of the transaction will be described; in the event that the offeree is an office holder or an interested party and the offering is made as part of his remuneration, an immediate report shall include the details specified in the Sixth Supplement to the Securities Regulations (Periodic and Immediate Reports) 5730-1970;
- The company's issued share capital, the quantity and the percentage of holdings of the offeree, company's interested parties, and the total holdings of the other shareholders in the company's issued and paid-up share capital and voting rights, as follows: before the issuance; following the issuance; in the event of convertible securities: following the issuance and assuming that the offeree will convert and exercise the securities issued to him under the offering; and, following the issuance, assuming that all existing and offered securities exercisable into or convertible into company shares will be converted and realised;
- Details with regard to the consideration: if the consideration is in assets other than cash, the primary facts with respect to the asset will be specified;
- The manner in which the consideration has been determined; and
- The name of every principal shareholder or officer in the company who has, to the best knowledge of the company, a personal interest in the consideration, and the nature of the personal interest of each of them.

Private Offering Which Is Not Substantial Private Offering. If the board of directors of a listed company has resolved upon a private offering other than a substantial private offering or an exceptional private offering, the company will publish an immediate report, specifying as follows:

- The terms of the securities proposed to be issued, their number and percentages in the voting rights, and the issued and paid-up capital of the company following the issuance as well as on a fully diluted basis;
- If securities of the series being offered are the same as those listed for trading on the Stock Exchange: the price of the securities being offered and the price of securities of the same series on the Stock Exchange on the day preceding the publication of the immediate report, as well as the percent proportion between them;
- The consideration;
- Written and verbal agreements, between the offeree and a shareholder in the company or between all or any of the offerees, between themselves or between them and others, concerning acquisition or sale of securities or in respect of voting rights, to the best knowledge of the company, following examinations it has conducted and specifying the same; and
- Specification of a limitation or restriction on the offered securities applicable to the offeree, pursuant to the regulations of the Stock Exchange, under any law or pursuant to an undertaking assumed by the offeree, to the best knowledge of the company.

Immediate Report on Outcome of Meeting. Not later than one business day following a general meeting convened for the approval of a private offering the company must file an immediate report on the results of the voting at the meeting, which will include the following details: the total number of shares participating in the voting, the number of shares voted for and against the offering, and their percentage out of the total number of voting shares, distinguishing between persons having a personal interest in the transaction and those who do not have a personal interest in the transaction.

Issuance to Employee. The provisions listed above will also apply to the issuance of securities to an employee under an employee's benefit program pursuant to an outline as defined in Section 15b(1) of the Securities Law.

Exemption from Disclosure in Report. A company whose securities are listed for trading on the Stock Exchange will be exempt from disclosing information in the report pursuant to the above provisions if, in the opinion of the Authority, the protection of a trade secret of the company justifies non-disclosure of such information, provided that, had the information in question been included in the report, a reasonable investor would not have abstained from purchasing the securities being offered. The fact that an exemption from disclosure was granted will be specified in the report.

Scope of Reporting in Respect of Exceptional Private Offering. The description of the corporation as stated below will include the following details:

- Description of the corporation, its activity, and business environment as well as those of any other corporation or activity purchased by the corporation, in

the form and specifications required in a prospectus, as detailed above under the description of the issuer provided in the Prospectus Regulations;

- Financial position of the corporation;
- Results of the corporation's business activities;
- Liquidity of the corporation;
- Sources of financing;
- Income of subsidiaries and associated companies; and
- List of loans.

Registration Procedure

The Stock Exchange Regulations also apply to the registration for trade of securities issued under a non-public offering ('private placement') and securities 'of a company whose securities are traded on the stock exchange' derived therefrom, *mutatis mutandis*, and with changes specified in the directives.[79] Registration for trade of securities issued in a private placement is subject to the following conditions:

- The percentage of public holdings following the issuance shall not be less than determined in the directives, provided the percentage of the minimum required public holdings does not exceed the percentage and value of the public holdings required from a new company of the same type; and
- The directives allow for alleviating rules for a company that announced in its most recent periodic report or in an immediate report that it is in difficulties and that it has initiated a recovery program, and the issuance is designated for the company's recovery ('company in difficulties'), provided that at least one of the conditions stipulated in the directives is fulfilled with respect to such company.

The aforesaid provisions will not apply to:

- A private placement to a provident fund, trust fund, and employees who are not interested parties in the company by virtue of shareholdings, and who will not become interested parties in the company by virtue of shareholdings following the issuance to employees, even assuming they will exercise all the convertible securities held by them that are not registered for trade on the Stock Exchange, including those issued to them in the private placement;
- A private issuance to an insurer against obligations arising from businesses of participating life insurance, as defined in the Insurance Business Control Regulations (Methods of Investment of the Capital, Funds of Obligations of an Insurer), 5746-1986;

79 Stock Exchange Regulations, ch L.

- A private placement to a foreign investor who is active in recognised markets and is a provident fund or a trust fund or an insurer, as against an obligation in the nature of participating life insurance; and
- A private placement in a listed company that is a banking corporation, subject to the circumstances and conditions as set forth in the Regulations.

Periodic Reports

Corporation's Duty to Report

A corporation whose securities have been offered to the public under a prospectus is required to submit to the Securities Authority the reports or notices set forth below, as long as its securities are held by the public.[80]

A corporation whose securities are traded on the Stock Exchange or listed for trade thereon is required to submit the reports or notices to the Stock Exchange, as well.

A document that must also be submitted to the Stock Exchange pursuant to the provisions of the Law and is electronically reported to the Authority, as detailed below, will be delivered by the Authority to the Stock Exchange, and such electronic report to the Authority will be deemed to constitute compliance with the obligation of submission to the Stock Exchange.

The details to be included in the reports or notices, their form, and dates of preparation and submission, including details therein that are presented 'to the best knowledge of the corporation's directors', must be stipulated in regulations to be enacted by the Minister of Finance as proposed by or after consultation with the Securities Authority, and with the approval of the Knesset Finance Committee.

These regulations shall refer to any matter which, in the opinion of the Minister of Finance, is of importance to a reasonable investor who is considering the purchase or sale of securities of the corporation, and also may relate to any of the matters set forth in regulations concerning publication of a prospectus as aforesaid, and will require, in addition to a periodic report, also an immediate report of specific events.

A corporation must submit to the Securities Authority, at the special demand of the Securities Authority or of an employee duly authorized by it for such purpose, within the period stated in such demand, provided such period being not less than the period prescribed in relation thereto in the Securities Regulations (Periodic and Immediate Reports), 5730-1970, an immediate report on any event or matter if, in their opinion, information regarding the same is important to a reasonable investor considering the purchase or sale of securities of the corporation.

80 Securities Law, ch F.

A corporation must submit to the Securities Authority, upon the demand of the Securities Authority or its authorised employee, in writing, explanations, details, information, and documents in connection with details contained in the report or notice submitted by a corporation; and submit a report that amends a report or notice that has been submitted as set forth above, within the period stipulated in such demand, if a report or notice that has been submitted does not comply with the aforesaid provisions, or that the details that were submitted require such amendment. The Securities Authority has the right to direct a corporation, after it has been given proper opportunity to state its arguments, to submit, within a period as it determines, the following:

- A report containing an opinion in addition to the opinion originally contained therein, if the Authority considers that the report was not submitted in accordance with the provisions of the Law, or that the details presented to the Authority as aforesaid require the above directive; and
- Financial statements, opinions, or reviews by the auditor who audited or reviewed them or by another auditor, to replace those included in the report submitted to the Securities Authority if, in its opinion, they were not prepared in accordance with generally accepted accounting principles and customary reporting standards, and do not duly reflect the corporation's state of affairs.

If the Securities Authority or an employee authorised by it for such purpose, are convinced that a corporation is unable to submit a report or notice under Chapter F of the Law within the period specified therefor in the Regulations, they may extend the date for submission.

Securities Authority's Power to Direct as to Manner of Presentation of Particulars

The Authority may instruct a corporation as to the manner of presenting items in the financial statements, the periodic report, or the immediate report, if it considers such action necessary to preserve the interest of the public investing in the securities of such corporation, provided that provisions with this regard were not stipulated in the Regulations as above or in the regulations with respect to items of the prospectus or in generally accepted accounting principles and customary reporting standards.

The Securities Authority also has the authority to determine general guidelines regarding the manner of presenting such items, which will be effective for a period of one year following the date of publication thereof, unless instructions with regard to such matter were previously determined in the Regulations or in the generally accepted accounting principles and customary reporting standards; the Securities Authority has the authority, with the approval of the Minister of Finance, to extend the effectiveness of the directives for a period not exceeding one additional year.

Exemption from Reporting

The Securities Authority may exempt a corporation from disclosing certain items in the report if, in its opinion, preserving the corporation's commercial secret justifies non-disclosure of such items, provided that had the said items been contained in the report, a reasonable investor would have refrained from purchasing the offered securities of such corporation.

The Court may exempt a corporation from disclosing an item in the report if it is of the opinion that such disclosure could be detrimental to the security or economy of the State of Israel or to an investigation conducted by the Israel Police or the Securities Authority, or the Ministry of Defence or the Minister of Finance, or the Minister of the Police or the Chairman of the Securities Authority, as the case may be, or anyone authorised thereby has confirmed in a signed certificate that such disclosure could be detrimental. If such exemption from disclosure is granted, such fact shall be stated in the report.

If a corporation did not submit a report as aforesaid on the date specified therefor, or submitted it not in accordance with the Law and the directives, or did not amend it within the period as prescribed by the Securities Authority or by an employee so authorised, or did not submit an explanation, detail, information, or document in regard with items included in the report or notice or did not submit an additional or other opinion as requested by the Securities Authority, the Court, upon the Authority's request, may order the corporation and its directors to submit the report or amend it or submit an additional or other opinion, within the time specified by the Court and, to the extent necessary, to order an interested party or a senior executive to submit a notice to the corporation as set forth below.

Principal Shareholder's Duty to Submit Notice

If the Reporting Regulations require a corporation to disclose in its reports details of its securities held by a principal shareholder or senior executive therein, or other details pertaining to a principal shareholder or senior executive therein, including changes in the said holdings, then the principal shareholder or senior executive shall submit to the corporation a notice providing such details, within such period so as to enable the corporation to fulfil its obligations. If the securities are held by a trustee, and the trustee submitted a notice pursuant to this requirement, the holder shall be exempt from submitting the said notice. Should the party submit such notice, the trustee shall be exempt. These provisions with respect to the duty of notification shall apply to a person who has ceased to be a principal shareholder or a senior executive, with respect to the event by virtue of which such person ceased to be a principal shareholder or a senior executive.

For the purposes of periodic reports a senior executive is defined as a (i) general manager, chief business manager, deputy to the general manager, vice-general manager, any person performing aforesaid functions in the company, and also any director or manager who is directly subordinate to the general manager;(ii) chairman of the board, substituting director, comptroller, internal auditor, an

authorized independent signatory; (iii) senior officer of the company which has a material effect on the corporation; and (iv) any individual holding another position in the corporation, which holds 5 per cent or more of the corporation's equity or voting rights.

If a principal shareholder or a senior executive has not submitted such notice or has submitted it in contravention to the provisions of the Law, the Court may, at the corporation's request, order it or him to submit or amend the notice within the period specified by the Court. The date for filing of a notice is no later than one trading day following the date of the event or matter in respect of which the notice must be submitted.

The date for filing a notice, in case of a change in the number of securities held by a principal shareholder, is immediately after the principal shareholder has learned of such change and, in any event, not later than one trading day following the date of such change.

The date for filing a notice regarding the appointment of a senior officer of the corporation is not later than the day of his appointment. The date for filing of a notice regarding the resignation of a senior officer is the date on which such senior officer notified the corporation of his resignation.[81] A holder of the corporations' securities, an interested party or a senior executive who submitted such report or notice will bear civil liability.

Directive to Cease Trading

Without derogating from the powers of the Stock Exchange, under its Regulations, to impose cessation of trading in securities, the Securities Authority has the authority, after consultation with the Chairman of the Stock Exchange's Board of Directors and after giving the corporation proper opportunity to state its arguments, to order the Stock Exchange to cease trading in the corporation's securities, if one of the following has occurred:

- It failed to submit a report or notice as aforesaid on the date specified therefore; or
- It submitted a report or notice which does not comply with the aforesaid, provided the Securities Authority is convinced that such deviation concerns material issues.

If the report or the notice has been subsequently submitted as required, to the Authority's satisfaction, the Authority shall instruct the Stock Exchange to resume trading in the corporation's securities.

81 Securities Regulations (Dates for Filing of Notice by a Principal Shareholder), 5763-2003.

Reporting Regulations

In General. The Reporting Regulations stipulate both technical and material provisions concerning details required to be included in the aforesaid reports or notices, the form thereof, and the dates on which they are to be prepared and filed.[82] The above Regulations contain various provisions relating to periodic and immediate reports, as well as to interim financial statements.

It should be noted that these Regulations have undergone material amendments as a result of the transition from the mode of handwritten reporting to electronic reporting, and in last several years as a result of the Authority's comprehensive approach intended to improve the current reporting practices of reporting corporations, pursuant to which the reporting requirements have been substantially extended, as detailed below. In addition to the Reporting Regulations, in certain events, such as a transaction between a company and its controlling shareholder and a private placement of securities in a listed company, provisions of several other regulations enacted pursuant to the Law and/or the Companies Law should be fulfilled with regard to immediate reports. Immediate and periodic reporting of a foreign corporation whose shares are listed for trading on a stock exchange in Israel within the double listing rules, are also regulated by specific regulations.

Incorporation by Reference. A corporation may incorporate in a report details that are required by the Reporting Regulations by way of reference to a quarterly report or to an immediate report as published by means of electronic reporting and filed in accordance with the Law, subject to certain terms and conditions as detailed under the Reporting Regulations.

Periodic Reports. The corporation must submit to the Authority a periodic report each year, within three months following the end of its reporting year, provided the report is submitted at least 14 days prior to the date specified for convening the general meeting at which the corporation's financial statements will be submitted, or within three days following the date of execution by the corporation's auditor of his opinion concerning the corporation's audited financial statements, whichever is earlier.

The execution date of the periodic report shall not be more than three days prior to the date on which such report is submitted to the Authority. The periodic report will include the documents and details as specified below, including a table of contents. The periodic report shall be divided into five chapters in accordance with the following order:

- Description of the corporation's business;
- Report of the board of directors on the state of the corporation's affairs;
- Financial statements of the corporation;

82 Securities Regulations (Periodic and Immediate Reports), 1970.

- Additional details concerning the corporation; and
- A report on the effectiveness of internal auditing on the financial reporting and disclosure.

A declaration signed by the Chief Executive Officer as well as a declaration signed by the most senior corporate financial officer, attesting to the accuracy of the reflection of the financial situation of the company in the periodic report shall be enclosed to a report on internal auditing.

As of 2004, pursuant to the recommendations of a special committee established to examine the matter of periodic reports submitted by corporations as part of the ongoing policy to simplify and avail information to the investors, the form of such reports changed, mainly by adding a chapter describing the corporation and its business, in an extent, form, and contents similar to those of a prospectus.

Description of the Corporation's Business. The periodic report shall include a description of the corporation and the progress in its business activities that occurred in the previous year, in accordance with the details and the principles in the First Schedule to the Securities Regulations (Details, Structure and Form of Prospectus) Regulations, 5729-1969, *mutatis mutandis*, and, wherever the Schedule includes the term 'prospectus', it will mean 'report'.

Valuation. If a very material valuation was used as the basis for determination of a reported value in a periodic report, including determination that the reported value should not be amended, the corporation shall attach the said very material valuation to the periodic report.

Notwithstanding the above, if a corporation publishes a valuation of a pledged asset (an asset pledged for securing a corporation's obligations under a debenture, excluding assets pledged by way of a floating charge over all of the corporation's assets) or certain figures under such valuation, an updated valuation must be attached to each periodic report subsequent to the above publishing date, until the full repayment of the debenture, even in the event such valuation is not a very material one; the said valuation shall be prepared in accordance with the provisions above and shall detail the material differences between it and the previous valuation of the pledged asset, published by the corporation.

If a valuation of a pledged asset is used to determine the value of the items published in the corporation's report, including an update of the previous valuation and determination that the value of the items regarding the asset in the report should not be amended, the valuation must be enclosed to the report, even in the event such valuation is not a very material one.

This provision shall not apply to very material valuations pertaining to lawsuits, client receivables, nor to inventory balances, nor to very material valuation used as the basis for determination of reported values of 'included affiliates', excluding 'included affiliates' whose financial statements are enclosed to the corporations report in accordance with the applicable provisions of the Financial Statements

Regulations. Excluding valuations conducted by the corporation itself, the valuation should, *inter alia*, reflect the following:

- Details of the corporation's organ that decided to contract the appraiser; and
- Existence of dependence between the corporation and the appraiser, to the extent that such dependence exists.[83]

Notwithstanding the regulations regarding incorporation by reference, a corporation may incorporate in its periodic reports by way of reference very material valuations that were released to the public by another corporation by means of electronic filing, even though four years or more have passed from the date of its publication until the date of the report in which the reference is made, provided that the very material valuation is presented in compliance with the provisions detailed above.

Valuations enclosed to the periodic report shall include all matters listed under the Third Schedule to the Financial Reports Regulations, as well as any other material detail which is important to a reasonable investor; in the event the valuation did not include all such details, the corporation shall complete those details in the periodic report.

If the language of the valuation is not Hebrew, the translation of the valuation into Hebrew, including a translator's certificate confirming the accuracy of the translation and his consent to include the translation and the certificate in the periodic report, shall be included in the report; valuations written in English should be included in the original language. If the effective date of valuation (the date to which the valuation refers) precedes the publication date of the periodic report by more than 90 days, the following should be stated in the periodic report:

- The period that elapsed following the effective date until the publication date of the periodic report, specifying that this period exceeds 90 days; and
- Changes that occurred following the effective date, which may alter the conclusions of the valuation, and the company's reasons for its inclusion in the periodic report despite the changes.

The Authority may exempt a corporation from including a very material valuation, in whole or in part, if it is persuaded, following the presentation of the corporation's case, that the exemption will not harm the interests of the public.

If a material valuation or a very material valuation were used to determine the value of the items in the periodic report, including determination that there is no need to amend the value of the said items, the following details shall be provided:

83 The corporation should state its nature and clarify why such appraiser was chosen over other independent appraisers.

- Subject of valuation (the asset, obligation, transaction, capital, activity, income, or expense, as the case may be);
- Timing of valuation;
- The value of the subject of valuation, determined in accordance with its valuation;
- The value of the subject of valuation immediately prior to the date of valuation, as it would have been if the generally accepted accounting principles, including depreciation and deduction, did not require the change in value in accordance with the valuation;
- The identity of the appraiser and its expertise, including education, experience in conducting valuations for accounting purposes in reporting corporations in similar scopes as the reported valuation, or in greater scopes, and the dependence on the party ordering the valuation, including reference to indemnification agreements with the appraiser;
- The valuation model applied by the appraiser for the purpose of the valuation; and
- The assumptions under which the appraiser carried out the valuation, in accordance with the valuating model, including capitalisation rate, growth rate, percentage value of discard of the total value determined in the valuation (Terminal Value), standard deviation, prices used as a basis for comparison, and bases for comparison.

The provisions of the Reporting Regulations with regard to description of the corporation's business and valuation, as well as the provisions with regard to the board of directors' report on the corporation's affairs and the summary of the quarterly statements of profit and loss, do not apply to:

- Banking corporations;
- Insurers;
- Information provided in a periodic report of a corporation with which a banking corporation is consolidated or partially consolidated or of a corporation for whom a banking corporation is an included affiliate, to the extent such information refers to the banking corporation;
- Information provided in a periodic report of a corporation with which an insurer is consolidated or partially consolidated or of a corporation for whom an insurer is an included affiliate, to the extent such information refers to the insurer; and
- Information provided in a periodic report of a corporation with which an Israeli corporation whose securities are registered for trade in a stock exchange outside of Israel (a special corporation) is consolidated or partially consolidated or of a corporation for whom a special corporation is an included affiliate, to the extent such information fulfills both of the following conditions: refers to a special corporation and is not subject to disclosure under foreign law that applies to the special corporation.

Financial Statements. In 2005, the professional committee of the Israeli Accounting Standards Board resolved that the financial statements of reporting corporations shall be conducted according to the International Financial Reporting Standards (IFRS), commencing on 1 January 2008.

This decision was an additional expression of the trend of globalisation that characterises international capital markets in general, and publicly traded corporations in Israel in particular, and is intended to facilitate a common accounting language, which is designed to increase the level of certainty, and decrease the costs of inspections and the costs of investments of foreign corporations in Israel.

This transition from the then-existing Israeli accounting standards to the IFRS was optional to all reporting corporations as of 2006 and, as stipulated above, has become mandatory on 1 January 2008.

The corporation's annual financial statements shall be presented, as of the date on which the corporation's reporting year ended (may also be referred as the "financial status report"), prepared according to generally accepted accounting principles, and duly audited. Financial statements shall also include the disclosure provisions as set forth in the Financial Statements Regulations. Periodic reports shall include an opinion by the corporation's auditor regarding the corporation's audited financial statements, and shall also include confirmation that the statements were prepared in accordance with the generally accepted accounting principles as mentioned above. Furthermore, such auditor's opinion shall be presented with respect to the financial statements of any company whose financial statements are attached to the corporation's financial statements.

An opinion will bear the date of signature by the auditor. Excluding financial statements of an affiliated company or a guaranteed company, which are not a reporting corporation, attached to the corporation's reports, the financial statements shall be signed, on behalf of the corporation, by the chairman of the board of directors, the general manager, and the most senior officer engaged in financial matters, or by a director who has been duly empowered by the board of directors, instead of any of the persons listed above, to sign the financial statements at a certain date, and the date of signature will be stated. The name of the signatory and his position in the company will appear next to every signature.

Pro-forma Report

In case a pro-forma event has occurred during the reporting year, following the date of the financial status report and prior to the date of the approval of the financial statements, or if it is virtually certain that the pro-forma event will be completed during the three months' period following the financial statements' approval date, provided that such completion does not involve substantive conditions, the following pro-forma data shall be included in the periodic report,

as well as the auditor's opinion and the assumptions on which such data is based:

- A financial status report which includes the impact of the pro-forma event, as of the end of the reporting year, unless the pro-forma event was fully reflected in the corporation's financial status report as of the end of the reporting year;
- A report regarding the total profit, which includes the impact of the pro-forma event (hereinafter: "the pro-forma total profit report") for each of the reporting years whose data are included in the corporation's financial statements; a corporation that presents the data on income and expenses, which were recognized during the period, in two separate reports, shall also include in the pro-forma total profit report a report that presents components of pro-forma profit or loss. If the aforementioned data did not appropriately reflect the effect of the pro-forma event on the corporation, the data of the pro-forma total profit report shall be included only for some of the reporting years whose data is included in the financial statements, to the extent that the pro-forma data shall appropriately reflect the effect of the pro-forma event on the corporation, and provided that it shall include data for the last reporting year, as well as explanation of the corporation on the non-inclusion of part of the aforementioned data;
- An additional financial statement, including a report on changes in equity and a cash flow statement, if requested by the Authority or of an employee authorized by the Authority; and
- The pro-forma financial statements shall be prepared, *mutatis mutandis*, in accordance with the Financial Statements Regulations, provided that the notes for the data that are included in the pro-forma financial statements shall be presented only to the extent they are necessary for the purpose of understanding same.

Notwithstanding the provisions mentioned above, if a pro-forma event occurs following the date of the financial status report and prior to the date of the approval of the financial statements, or if it is virtually certain that the pro-forma event must be completed during the three months following the financial statements' approval date, provided that such completion does not involve substantive conditions, the corporation may publish a pro-forma statement by means of an immediate report, within 90 days following the date of the pro-forma event or of its completion, as the case may be, or in the quarterly report for the period in which the pro-forma event occurs, whichever is earlier.

Subject to the applicable provisions of the Regulations, the Chairman of the Authority may (i) instruct a corporation to release pro-forma report also in circumstances that do not constitute a pro-forma event; (ii) instruct a corporation to release the pro-forma data by means of an immediate report; or (iii) exempt a corporation from releasing pro-forma report.

"Pro-forma event" means any one of the following: (i) a material business combination, provided any of the following shall be deemed the same - (a) the

percentage of the profit or the loss of a acquired corporation for the period referenced in the report or the results of the acquired activity during the last year, which can be attributed to the corporation, due to its holding in the equity of the purchased corporation or the purchased activity, respectively, represent, in absolute terms, thirty percent or more of the profit or loss of the corporation for the period, which is attributed to the owners of the parent company, during the same period in absolute terms, according to the corporation‘s and acquired corporation’s last financial statements respectively; (b) the corporation‘s share of the acquired corporation or of the acquired activity, multiplied by the total of the acquired corporation‘s assets or the total of the acquired activity, as the case may be, represent, in their absolute value, thirty percent or more of the corporation‘s total assets, in their absolute value, according to the financial statements of the corporation and the acquired corporation; (ii) a material sale of securities of, or rights in, a corporation whose financial statements have been consolidated or proportionally consolidated with the corporation‘s financial statements, or a sale of a material portion of the corporation‘s activity.

Report on Effectiveness of Internal Auditing of Financial Reporting and Disclosure

According to an amendment to the Securities Regulations (Periodic and Immediate Reports), 1970, applicable since 2010, a corporation, excluding a bank corporation and insurer, shall enclose to the periodic report, an annual report specifying the evaluation of the Board of Directors and the management with regard to the effectiveness of the internal auditing. The annual report on internal auditing will address the following:

- A disclosure whether the internal auditing was evaluated as effective. If a material weakness was found in one of the following internal auditing components, then the internal auditing shall be deemed ineffective: (1) Entity Level Controls; (2) controls on reports preparation and approval process; (3) Information Technology General Controls (ITGC); and (4) controls on processes deemed very material for financial reporting and disclosure (hereinafter: “the Internal Auditing Factors”).
- If a disclosure regarding the existences of material weakness has been provided for the first time in the annual report on internal auditing and such material weakness was not cured by the date of the subsequent annual report on internal auditing, then as of the date of such subsequent annual report, the reports of the corporation shall be deemed non-compliant with the law. The Chairman of the Authority or anyone authorized by him in writing may exempt a corporation from the aforesaid limitations, or extend a conditional exemption, if he believes that under those specific circumstances the corporation was prevented from curing such material weakness as of the aforementioned date. If such an exemption has been granted, that fact shall be stated in the annual report on internal auditing.
- If the internal auditing has been evaluated as ineffective, all the existing material weaknesses in the internal auditing as of the date of the report, the

date on which they were firstly disclosed, their effect on the financial reports and on disclosure, the actions taken until the date of the report in order to cure the material weaknesses and the timetable and actions that the corporation intends to take in order to complete this curing, shall be described. In addition, the actions taken by the corporation in order to ensure that the reports are prepared according to applicable law, despite the existence of the material weaknesses, shall be specified.

- All material weaknesses that were cured during the reported year will be specified, including the date of the report in which they were first reported, except for material weaknesses that were discovered and cured within the same quarter.
- Details regarding the manner and scope of the evaluation of the internal auditing effectiveness by the corporation, and
- In the annual report on internal auditing, the corporation may include additional details regarding significant defects discovered in its internal auditing as of the date of the report.

A report by the corporation‘s auditor will be enclosed to the annual report and will include his opinion regarding the effectiveness of the internal auditing of the financial reports and describe the material weaknesses that he identified in the internal auditing, including those that were not properly disclosed in the evaluation of the Board of Directors and the management as described in the annual report on internal auditing. Such auditor’s opinion shall refer to each one of the Internal Auditing Factors.

Declarations shall be enclosed to the annual report on internal auditing, one signed by the Chief Executive Officer; and another signed by the most senior corporate financial officer. The aforementioned declarations do not detract from the responsibility of their signatories or the responsibility of any other person, according to any law.

The Chairman of the Authority may instruct that the internal auditing effectiveness report of a particular corporation shall be in the format determined by a different law or other arrangement, if he believes that under those specific circumstances a different law or arrangement applies to the corporation.

Separate Financial Report by Corporation

The periodic report shall include, together with the opinion of the auditor, financial data out of the corporation‘s consolidated financial statements which are attributed to the corporation itself as a parent company, and any and all material information which is important for a reasonable investor in order to understand the corporation‘s financial situation, the results of its activities and its cash flow, or is likely to affect financial decision made with respect to the corporation, as described in the Tenth Schedule to the Securities Regulations (Periodic and Immediate Reports), 1970.

Report on Debenture Inventory According to Date of Redemption

According to an amendment to the Securities Regulations (Periodic and Immediate Reports), 1970, applicable since 2011, the majority of corporations, are required to enclose to their periodic report, a report concerning the liabilities of the reporting corporation and the consolidated companies or the companies proportionately consolidated in its financial statements. In general, such report will include insofar as regarding the liabilities of the reporting corporation as a separate legal entity, debentures issued by the reporting corporation and held by the public as well as debentures that are not held by the public, credits received by the reporting corporation from an individual or from a non-bank corporation, credits received by the reporting corporation from a company that has received a bank license according to Clause 4 of the Banking Law (Licensing) — 1981, etc. In addition, in respect of consolidated companies and proportionately consolidated companies of the reporting corporation, it shall specify total financial guarantees and commitments for the provision of credit provided by the consolidated companies and credit and liabilities balances.

The report shall include data regarding credit from companies in the group or debentures held by companies in the group, including, *inter alia*, the following: (i) credit received by the reporting corporation from its parent company or controlling shareholder and the total balances of debentures issued by the reporting corporation that are held by them; (ii) credit received by the reporting corporation from companies controlled by its parent company or companies controlled by its controlling shareholder and which are not controlled by the reporting corporation and total balances of debentures issued by the reporting corporation that are held by them.

The disclosure as mentioned in this paragraph shall be provided by redemption dates, based on the accumulated amount of the repayments according to the terms of the debentures for each of the four years commencing at the end of the reporting period which the financial statements relate to, and accumulated amount in relation to the fifth year and onward; the disclosure will differentiate between payments of principal and interest, with a breakdown of the liabilities according to their terms of linkage.

Board of Directors' Report on Corporation's Affairs.

The board of directors shall present a report on the corporation's affairs in the reporting year, which shall contain the board of directors' explanations relating to the state of corporation's business affairs, the results of its operations, its equity capital, and cash flows; the explanations shall relate to the way the events affected the figures in the report, if this effect is material, and the reasons for the

changes occurred in the corporation's state of affairs in comparison with the reporting years contained in the financial statements.[84]

The board of directors' report shall relate to the principal figures in the financial statements, and may include additional information in the corporation's possession with respect to the reported year if, in the board of directors' opinion, they are important for a balanced understanding of the corporation's business position by a reasonable investor considering purchase or sale of the corporation's securities.

The board of directors' report will also include details as to accounting exposure of the corporation to market risks and the ways in which they are managed, including the market risks that relate to equity values, the net profit or loss, or the cash flow that is included in the corporation's financial statements, the market risks that relate to the value of the corporation or to its cash flows and an itemised breakdown concerning the management of market risks, with a reference to the steps that the corporation is taking in order to address its exposure to market risks (as such term is defined under GAAP). The need for reporting such particulars has even intensified in view of the increasing use by companies of sophisticated and complex financial instruments, the use of which may expose the company to a higher level of risk, without such exposure being suitably expressed in the financial statements.[85]

The required reporting standard includes a broad duty of disclosure that applies to companies, in relation to the market risks to which they are exposed during the course of their activity, to achieve a double objective:

- Improving the ability of the investors to make reasoned decisions, which is designed to lead to greater market efficiency; and
- Creating a risk management culture and awareness in companies, and increasing the awareness of the senior management echelon to the importance of the subject.

The board of directors' report shall be in a prescribed format. The explanations shall relate to every one of the following subjects:

- Financial position;
- Results of operations;
- Liquidity;[86]

84 This requirement does not apply to certain corporations, as detailed above.

85 The issue of the company's exposure to market risks is given stronger emphasis *inter alia*, given the events that led to the enactment of the Sarbanes-Oxley Act of 2002.

86 If the public held debentures issued by the corporation on the date of the report which were offered under a prospectus (hereafter: debentures in circulation) and the board has determined, for the purpose of examining the warning signs as detailed hereafter, that a working capital deficit or ongoing negative cash flow from current operations

- Financing resources;
- *Pro forma* details as provided in the pro forma report; and
- Major details from the description of the corporation‘s business.

Within the framework of the said subjects, the board of directors shall refer to the matters set forth in the First Addendum to the Reporting Regulations, to the extent they affect the corporation, and additional matters that are important, in the board of directors' opinion, for an understanding of the corporation's affairs, as aforesaid. Matters addressed in the First Addendum to the Reporting Regulations, include the following:

- Financial Situation Explanations —developments that have occurred in the financial status report items and in the following matters: acquisition or realisation of fixed assets, land and facilities, including real estate for investment and real estate for development, which is likely to have a material effect on future activities of the corporation — the purpose of such acquisition or realisation will be specified, as well as the sector of the activity that will be served by such acquisition or from which the asset was extracted and the manner in which such acquisition was financed; the exposure studied from the information included in the financial statements, and protective steps taken by the corporation;
- Business Results Developments — explanations regarding developments concerning the total profit report items, including all income and expense items that were recognized during the period, whether a single report or two reports that differentiate between profit or loss components and other total profit components were presented;
- Liquidity — explanations regarding the state of liquidity of the corporation and cash flow from current activity, from investment activity, and from financing activity;
- Sources of Financing — explanations regarding the sources of the corporation's capital as well as their cost and changes that have occurred in them, by reference, to the issue of securities, exercise of options, or conversion of securities convertible into shares, the average volume of long-term loans during the reporting year, the average volume of short-term credit, suppliers' credit and credit from customers or, alternatively, the range of such credit as given above, all if a substantial hiatus exists between them; and
- Explanation regarding very significant figures that appeared within the framework of the Company's statements of operations in accordance with the details and the principles in the First Schedule to the Securities Regulations (Details, Structure and Form of Prospectus), 5729-1969, and for which no explanation was given within the framework of the above matters.

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does not indicate a liquidity problem, the report must detail the examination performed and the reasons for its decision.

No reference are required to be made to matters that do not affect the corporation, or which, in the board of directors' opinion, are immaterial, or the absence of which would not impair an understanding of the state of the corporation's affairs. The information set forth in the financial statements should not be repeated. The following issues shall be addressed:

- Any effect caused by events and trends in the corporation's activities and its business environment, and the liabilities undertaken by the corporation, on the figures in the financial statements;
- Exceptional or one-time events;
- Events that may indicate financial difficulties;
- The effect of a joint transaction, an investment in another company or corporation, or increase or decrease in the rate of participation in such transaction or investment, on the figures in the financial statements, if such effect is very material;
- Explanations concerning issues, to which the corporation's auditor has drawn attention in his opinion on the financial statements, and the effect of special contracts, as defined in the Financial Statements Regulations, on the financial statements' figures; and
- Acquisition plans reported by the corporation during the reported period or effective as of the date of the report, including details of the manner in which the plans will actually be implemented; for this purpose, acquisition shall mean paying a dividend or an undertaking to do same, directly or indirectly, and also acquiring, or providing the financing for the acquisition, directly or indirectly, by the company or by its subsidiary or by another corporation that it controls, of company's securities, or redemption of redeemable securities which are part of the company's share capital, and including an undertaking to do each of the foregoing, all provided that the seller is not the company itself or another corporation fully owned by the company.

Explanations must be provided regarding material changes which occurred in the corporation's activity and its affairs and with respect to the data in its financial statements' in each quarter in the reporting year and, in particular, in the fourth quarter. Explanations shall be provided regarding the relationship between the compensation made to each of the five highest paid employees among the corporation's senior officers, the contribution to the corporation by the persons receiving the compensation and whether such compensation is fair and reasonable. Reference must be made to events occurring after the financial report date as mentioned in the financial statements.

Details shall be provided concerning the corporation‘s policy with regard to charitable donations, if any such policy has been established, and concerning the incorporation of such policy within the corporation‘s business; details shall be provided of the amounts of the corporation‘s donations in the reported year, indicating any undertaking to make donations in future periods.

The board's report shall provide details concerning exposure to market risks and the methods implemented in their managing, concerning the following topics that are detailed extensively in the second schedule to the Reporting Regulations: the persons in the corporation in charge of management of market risks, a description of the market risks to which the corporation is exposed, the corporation's market risk management policy, the supervision over such risk management policy and the method of its implementation, index bases report, maximum holdings in derivatives, positions in derivatives, and events occurring after the date of the financial status report concerning exposure to market risks and their management (see discussion on the subject in previous sections).

If a significant disparity exists between the actual outcome and material assumptions, evaluations, and projections which are the basis of valuations, including a professional opinion attached to the report, during the last three years preceding the reporting date, such disparity should be stated, specifying the reasons therefor and its impact on the value set.

As of 2006, the Reporting Regulations require that detailed explanation, pertaining to directors with accounting and financial expertise, shall be presented in board's report as follows:

- The minimum required number of directors with accounting and financial expertise shall be specified, in accordance with the decision of the board of directors under the provisions of the Companies Law (the 'minimum number'), as well as the board's grounds for the decision, with reference to liabilities, authority, and duties imposed on the board of directors in accordance with the law, and by taking into consideration the type of company, the size, scope, and complexity of its activity;
- If the board of directors has changed its resolutions pertaining to the minimum number during the reporting period, the change should be stated and the board of directors' reason therefor should be specified;
- If the number of directors with accounting and financial expertise falls below the minimum number, the reasons therefor should be specified, along with measures which the company intends to take to comply with the minimum number and the timetable provided for the aforesaid compliance; and
- With regard to each director whom the company perceives as possessing accounting and financial expertise (including an individual who acts on behalf of a director that is a corporation, having accounting and financial expertise), the following should be stated: name, qualifications, education, experience, and knowledge that constitute the basis for the company's determination of him as having accounting and financial expertise.

As of 2009, and following an amendment to the Companies Law allowing public companies, if they so choose, to amend their Articles of Association to include the requirement that such companies' board of directors will also include members qualifying as Independent Directors (directors with qualifications of external directors who have not served as directors in such company for more than

nine years). The Reporting Regulations require that additional information will be provided regarding such directors, as follows:

- Whether the articles of a public company include a provision regarding the number of independent directors, or do not include such provision, and whether the articles were amended during the reported period revoking such provision; and
- In the event the articles of a public company included a provision as detailed above and the number of independent directors decreased below the required number, such fact will be stated in the report along with the actions which the company is planning to take in order to meet the required number, including timetables.
- In the event that a corporation has submitted a report (hereinafter: the original report) pertaining to an event or matter (hereinafter: a possible event or matter) that could occur at a date later than the one stated in the report, the corporation shall submit a report pertaining to all significant developments that occurred with respect to the possible event or matter and an update shall be included with regard to each possible event or matter and shall also prescribe any update regarding same; if the original report states the anticipated date for a possible event or matter, the corporation must submit an immediate report pertaining to the situation regarding the possible event or matter, as of the anticipated date. An update shall be included in the board of directors' report with regard to each possible event or matter. Details regarding the corporation's internal auditor shall be provided as prescribed in the Fourth Schedule of the Reporting Regulations.
- Details regarding the corporation‘s external auditor shall be provided as prescribed in the Seventh Schedule of the Reporting Regulations.
- Details shall be provided regarding the corporation‘s debentures as follows: With respect to debentures in circulation on the date of the report, details will be included in the report regarding each series of debentures as of the end of the reporting year as prescribed in the eight schedule of the Reporting Regulations and it will be stated whether each series is material; for this purpose, a debenture series will be considered material if it reflects, as of the end of the reporting year, five percent or more of the company‘s total liabilities. In addition, a description and explanation will be provided of significant events and changes that have occurred with respect to the aforementioned debentures subsequent to the date of the financial status report. If debentures were redeemed in full during the reported year or subsequent to it, this fact will be stated. If the aforementioned debentures were redeemed not in accordance with their original terms, the corporation will provide the reason for the redemption and the differences between the actual redemption terms and those of the debentures.
- With respect to debentures in circulation, details will be provided regarding warning signs in the corporation as follows: If warning signs appear in the corporation, the corporation will attach a forecasted cash flow report, as well as an explanation by the Board of Directors. However, the corporation may

refrain from attaching the aforementioned cash flow report, even though warning signs exist, if its Board of Directors has determined that there is no reasonable concern that during the forecasted cash flow period the corporation will not meet its existing and expected obligations as they mature. If the Board of Directors determined that there is no such concern, it will state that fact and provide an explanation of it. For these purpose: "Forecasted cash flow report" shall mean — a list of the existing and expected liabilities that the corporation will be required to redeem during the two-year period commencing at the end of the reported period or the date of the report, as the case may be, as well as a list of the financial sources from which the corporation expects to redeem the aforementioned liabilities. "Warning signs" — are any of the following: (1) A deficit in equity; (2) An opinion or review by an accountant as of the date of the report that relates to the difficulties in obtaining financing for the corporation‘s activity, the dependency of the corporation‘s continued activity on the attainment of additional means of financing, the dependency of the corporation‘s continued activity on an event substantially uncertain to occur, the existence of persistent losses or any other indication of the existence of difficulties related to the continued activity of the corporation; (3) A deficit in working capital together with a persistent negative cash flow from current activity; or (4) A deficit in working capital or an ongoing negative cash flow from current activity, provided the corporation's board of directors has not determined that this is not an indication of a liquidity problem in the corporation. Forecast flow report provisions shall not apply to (1) A corporation that has issued debentures to the public and at the date of their issuance was (i) an issuer offering investment grade certificates of indebtedness, the entire proceeds of which are to be invested in the debentures of an investment grade banking corporation or insurer, and the repayment of the debentures of the banking corporation or insurer is intended to be used for the repayment of the issued certificates of indebtedness, or (ii) an issuer offering investment grade certificates of indebtedness, all of which are to be deposited in an investment grade banking corporation or insurer, where the deposit will be used for their repayment (2) The issuers of index products; and (3) A corporation, for which the opinion of the accountant that is attached to its financial statements as of the date of the report, draws attention to the existence of significant doubts with regard to the continued existence of the corporation as a going concern.

- Details shall be provided regarding the corporation's financial statements approval procedure, including the identity of the corporation's organs which are in charge of supreme control, specifying the names and positions of officers among them, as well as the processes taken by the organs which are in charge of corporation's supreme control prior to the approval of the corporation's financial statements.

The board of directors' report of a corporation which prepared consolidated financial statements, shall refer to such statements. The report of the board of directors must be drafted in a clear and understandable format and shall be

divided into the topics detailed above, but the board of directors may combine the explanations on subjects and matters that are interconnected if, in its opinion, this will contribute to the clarity of the report.

The board of directors' report must be approved by the corporation's board of directors, simultaneously with approval of the financial statements, and shall be signed by the chairman of the board of directors or another director authorized for that purpose by the board of directors, and the chief executive officer or whoever fulfils such position in the corporation, even under a different title.

Summary of Quarterly Statements of Profit and Loss. A table shall be presented containing a summary of the corporation's statements of its total profit for each quarter in the reporting year, in the format of interim financial statements.[87] A corporation that presents the data on income and expenses that were recognized during the reporting year in two separate reports shall also include in the total profit statement a report presenting components of profit or loss, as defined in generally accepted accounting principles, for each of the quarters.

Use of Proceeds of Securities. The report shall provide details regarding the use made by the corporation of the proceeds from the sale of any securities offered under the prospectus most recently published before the date of the report, making reference to the designation of the proceeds as set forth in the prospectus, the amounts required to achieve each of the objectives, the date of achievement thereof, and details of the current status of the objectives that have not yet been achieved.

The amounts to be specified with respect to the proceeds shall be determined at the level of prices on the prospectus date, in comparison to the level of prices on the report date. If one or more of the designated objectives stated in the prospectus was not achieved, or was not achieved in accordance with the anticipated timetable, such fact shall be indicated, and the reasons therefor shall be detailed. If, during the reporting year, the corporation exercised a right it had reserved in the prospectus to alter the objectives for which the proceeds were designated, or the amounts or the timetable required to achieve one or more of the objectives, the amended provisions shall be stated and detailed as set forth above. The said data shall be presented so long as all of the proceeds have not been expended and a final statement specifying the designation of the proceeds has not been filed.

List of Investments in Subsidiaries and Affiliated Companies. The report shall include a list of the corporation's investments at the financial status report date in each of its subsidiaries and affiliated companies, containing, inter alia, the following details:

87 This requirement does not apply to certain corporations, as detailed above (under Periodic Reports).

- The number of shares or convertible securities of all classes, their par value, their adjusted cost at balance sheet date, their value in the corporation‘s solo based financial report, the price of the shares or the convertible securities listed for trade on the Stock Exchange on the financial status report date and, if no trade was conducted on the financial status report date, on the last trading day preceding it, and the percentage of shares and convertible securities held by the corporation out of the total amount of the issued securities of same class;
- The percentage of each subsidiary‘s and affiliate‘s issued share capital, the voting power, and the authority to appoint its directors, as held by the corporation; and
- The balance of debentures and loans in the financial status report, their principal terms, including redemption years, linkage terms of the principal or interest and the linkage basis, details regarding the rights to convert the debentures or loans for shares or other securities, and the price of the debentures registered on the Stock Exchange on the date mentioned above.

Changes in Investments in Subsidiaries and Affiliated Companies. The report shall include details regarding the changes in the corporation’s investments during the reported year in any subsidiary and any affiliated company, including dates of the changes and the principal terms of the transactions connected with such changes. These details shall also be presented with respect to changes in a company which became or ceased to be a subsidiary or affiliated company of the reporting corporation during the reported year.

Income of Subsidiaries and Affiliated Companies and Income Therefrom. The report shall specify the total profit of each subsidiary or affiliated company of the corporation, in the last reporting year that ended on the date of the corporation‘s financial report, or prior to that if it is adjusted to the corporation’s financial report date. The following data shall be presented, differentiating between profit or loss and other total profit, as defined by generally accepted accounting principles:

- The dividend and management fees received by the corporation prior to its financial report date from every such company for the reported year, as well as such payment for the subsequent period, all adjusted to the corporation’s financial report date;
- The dividend and management fees received by the corporation following its financial report date or which it is entitled to receive from each such company for the reported year, as well as such payment for the subsequent period, indicating the dates of payment; and
- The interest the corporation received or which it is entitled to receive from each company for the reported year, as well as for the subsequent period, indicating the dates of payment.

List of Loans. Should the corporation's major business activities include providing loans, the report shall include the loan balances as at the financial report date, classified in appropriate groups according to the amounts of the loan balances and indicating the number of borrowers included in each group. If a borrower received more than one loan, all the loans received by it shall be deemed as one loan in an amount equal to the total balance of all his loans.

Trade on the Stock Exchange. If securities issued by the corporation were registered for trade on the Stock Exchange during the reporting year, or if trade therein had been ceased during that period, the class of the said securities and their par value must be stated; if trade had been ceased, the reason for such cessation shall be specified.

Payments to Senior Officers. The report must provide the details with respect to remuneration[88] granted during the reporting year to (i) each of the top-five remuneration receivers amongst the senior office holders of the corporation or a corporation under its control, if such remuneration was granted in connection with such office holders' services to the corporation or to a corporation under its control, whether such remuneration was provided by the corporation or by another party; if a person served as a senior office holder of more than one corporation of the abovementioned corporations, his remuneration for the purposes herein shall be accumulated; (ii) each of the top-three senior office holders receiving the highest remuneration from the corporation, if such remuneration was granted in connection with such office holders' services to the corporation and if he is not listed as one of the top-five remuneration receivers detailed above; and (iii) any principal shareholder in the corporation, excluding the corporation's subsidiaries, who is not one of the remuneration receivers detailed above, whether remuneration was provided to him by the corporation or by a corporation under its control with respect to services he provided as an officer in such corporations, whether employment relationship exists or not and also in the event the principal shareholder is not a senior officer in such corporation. The said details must be provided also with regard to any remuneration provided to them following the reported year and prior to the submission date of the report, in connection with their services or employment during the reported year, but was not recognized in the financial statements for the reported year.

The name of the corporation's controlling shareholder and, if control has been transferred during the period described in the report, the name of the corporation's controlling shareholder during the aforementioned period, shall be stated.

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88 The definition of "remuneration" includes an undertaking to provide remuneration, directly or indirectly, including any sum of money and or payment in kind, salary, bonus, management fee, advisory fee, rent, commission, interest, share based payment, retirement remuneration which is not pension payment, and any benefit, all excluding dividends.

Transactions with Controlling Shareholder. The report shall include details, to the best of the corporation's knowledge, regarding any transaction with a controlling shareholder or any transaction in the approval of which the controlling shareholder has a personal interest, which the corporation had entered into during the reported year or further on until the report's filing date, or which is still ongoing at the date of the report, including details with regard to the identity of the parties to the transaction, its nature, qualitative and quantitative characteristics, personal interest of the controlling shareholder, date of approval, and details of the corporation's organ which approved the transaction; such details shall be provided while distinguishing between an exceptional transaction with a controlling shareholder pursuant to Section 270(4) of the Israeli Companies Law and other transactions.

Holdings of Principal Shareholders and Senior Officers. The report shall specify, to the corporation's best knowledge, (i) the holdings of the corporation's shares and other securities held by each principal shareholder on the date of the report, or on a date immediately prior thereto, including the name of each principal shareholder, the percentage of the corporation's shares, and each of the other securities held by him on that date, and on a fully diluted basis, and the par value of the corporation's shares which he undertook to purchase or which the corporation undertook to sell him; (ii) the holdings of a principal shareholder, on the date of the report or on a date immediately prior thereto, in shares or other securities of a company held by the corporation if its activity is material to that of the corporation.

Details also must be provided, to the best of the knowledge of the corporation, regarding dormant shares (shares of the company that have been acquired by it directly and/or through companies that it controls, and which do not confer any rights for as long as such shares are held by the company or a party acting on its behalf), and securities that are convertible into or exercisable as dormant shares, which the corporation or a subsidiary or other corporation controlled by the parent company (shares of the company held by a subsidiary or another corporation controlled by the company which do not bestow voting rights as long as the company's shares are held by them) holds in the corporation at the date of the report or at a date as near as possible thereto, giving itemised details of the holder's name, the amount of shares held by it and in each of the corporation's convertible securities on the date set forth above, and on a fully diluted basis, and the par value of the corporation's shares which it undertook to purchase or which the corporation undertook to sell to it. The corporation and its senior corporate officers who hold the corporation's securities will be deemed the corporation's principal shareholders.

Authorized Capital, Issued Capital, and Convertible Securities. The report must detail the authorized share capital of the corporation, its issued share capital and its issued share capital excluding dormant shares, differentiating between the number of shares that do not confer voting rights and the number of shares that do not confer any rights whatsoever; details of the corporation's convertible securities

will also be provided. The report must also include the corporation's shareholders' register.

Registered Address. The registered address of the corporation, its e-mail address and telephone and telefax numbers, shall be specified.

Directors of the Corporation. With regard to each of the directors and alternate directors of the corporation, the following must be specified:

- Name;
- Identity number;
- Date of birth;
- Address for service of court papers;
- Nationality;
- Membership in a committee or committees of the board of directors;
- Whether he is an independent director or an external director as defined in the Companies Law, whether he has accounting and financial expertise or professional qualifications, and whether he is an expert external director;
- If he is an employee of the corporation, of its subsidiary, of its affiliate, or of a principal shareholder therein - the position or positions that he holds;
- The date on which he began holding office as director of the corporation;
- Education and occupation in the last five years, providing details of the corporations in which he serves as director, as well as details of his education and stating his professions or fields of the education, the institution in which the education has been acquired, and the academic degree or professional diploma he holds;
- Whether he, to the best of the corporation and its directors' knowledge, is a relative of another principal shareholder in the corporation, providing details if any; and
- Whether he is a director deemed by the company to possess accounting and financial expertise required to comply with the minimum stipulated by the board of directors in accordance with the provisions of the Companies Law.

The Authority may exempt the corporation from disclosing an item as detailed above if it believes that the circumstances of the case justify this. As of 2011, corporations cannot serve as directors in public companies.[89]

Senior Office Holders. With regard to each of the senior office holders of the corporation, as to whom the aforementioned details were not included in the report, the following shall be stated:

- Name;
- Identity number;

89 Companies Law, s 235

- Date of birth;
- Date on which he began to hold office;
- Position he holds in the corporation, its subsidiary, its affiliate, or a principal shareholder thereof; if the senior office holder is an independent authorized signatory of the corporation, such fact will also be indicated;
- Whether he is a principal shareholder in the corporation or a family member of another senior office holder or a principal shareholder in the corporation; and
- Education and business experience in the last five years; details of the senior office holder's education including: professions or fields of acquired education, the institution in which the education has been acquired, and the academic degree or professional diploma he holds.

Authorised Signatories. Details must be provided with respect to the number of independent authorised signatories as determined by the corporation.

Report about Directors. As a result of the credibility crisis that has beset the global capital markets and principally the American capital market, which has exposed weaknesses in the functioning of boards of directors and particularly in relation to their ability, in practical terms, to take action to ensure disclosure and proper reporting by the company to the public, and in light of the complicated financial realities in which public companies are currently operating and which make increasing use of sophisticated and complex financial instruments such as derivatives and, in view of the complexity of the business environment, the accountancy reporting rules, and the economic and legal environment in which public companies currently operate, the Companies Regulations (Terms and Conditions for a Director with Accounting and Financial Expertise and a Director with Professional Expertise), 5765-2005, were enacted, replacing a special directive in this matter enacted by the Authority.

According to the Companies Law, in addition to an external director (as defined in the Companies Law) having accounting and financial expertise (as defined hereunder) serving in a public company or in a private company whose bonds are listed for trade on the stock exchange or were offered to the public pursuant to prospectus or offered to the public outside of Israel pursuant to a public offering document required by the law outside of Israel, and held by the public (hereinafter: a "Debenture Company"), additional directors, having accounting and financial expertise, shall serve on the board of such companies. The minimum number of directors with accounting and financial expertise shall be determined by the board of directors of each such company, while taking into account, *inter alia*, the type of the company, its size, the scope of the company's activity, and the complexity thereof, and subject to the number of directors as determined in the company's articles of association.

The aforementioned Regulations are intended to reduce, to the extent possible, the gulf that has, on numerous occasions, been revealed between the abilities and individual qualifications of certain directors and the combined abilities and

qualifications of boards of directors in certain companies, and the scope and complexity of the obligations imposed on them.

Under the Regulations, a director with accounting and financial expertise is one who, due to his education, experience, and qualifications, has high expertise and understanding in business and accounting issues, as well as in financial statements, in a manner allowing him to deeply understand the corporation's financial statements and raise a debate as to the manner in which the financial data is presented. In evaluating the accounting and financial expertise of a director, the overall considerations to be taken into account by the board of directors are his academic qualifications, his experience, his knowledge, and the degree to which the director is familiar with the following matters:

- Accounting issues and auditing issues that characterise the sector of business in which the company operates and the company's approximate size and complexity;
- The functions of the auditor, and the obligations imposed on him; and
- The processes of preparation of financial statements and their approval pursuant to the Securities Law and the Companies Law.

A director will be deemed to have professional skills in each of the following cases:

- He holds an academic degree in one of the following subjects: economics, business management, accounting, law, or public administration;
- He holds a different academic degree or finished another academic studies, all in the company's main field of business or in a field relevant to the office; or
- He possesses at least five years' experience in at least one of the following, or has an accumulated five years' experience in at least two of the following: (a) a ranking office in the business management of a corporation with a significant business scope; (b) a senior public office or a senior office in the civil service; and/or (c) a senior office in the company's main fields of business.

The evaluation of the professional skills of a nominee to serve as a director shall be performed by the board of directors. A nominee shall declare in writing details regarding his education and experience, as well as attach documents and diplomas supporting his declaration, relevant for examining whether he complies with the aforementioned requirements. Such declaration shall be attached to the company's immediate report regarding the proposed appointment of a nominee as a director. The issue of fitness and expertise of nominees to serve as directors in public companies is also addressed under the new corporate governance regime[90].

90 See further details under 'Corporate Governance' hereinbelow.

Company's Accountant. The name of the company's accountant and the address of his office must be detailed in the report. If, to the best of the company's knowledge, the accountant or his partner is a principal shareholder or a relative of a principal shareholder or of a senior office holder in the company, appropriate details must be provided.

Scope of the Internal Auditors Work. The report must provide details with respect to the scope of the internal auditor's work, including the number of yearly working hours, the explanation for determination of such scope of work, and its flexibility, and distinguishing between the hours spent in internal auditing (i) of the corporation, (ii) its subsidiaries, (iii) with respect to activity inside Israel, and (iv) outside Israel.

Change in Memorandum or Articles. Any change to the corporation's memorandum or articles of incorporation in the reported year shall be presented.

Recommendations and Resolutions of Directors. The report shall present the recommendations of the directors to the general meeting as well as their resolutions that do not require approval by the general meeting concerning:

- Payment of dividends or making a distribution, [91] by other means, or distributing bonus shares;
- Change in the corporation's registered or issued capital;
- Change in the corporation's memorandum or articles;
- Redemption of redeemable securities;
- Early redemption of debentures; and
- Transaction between the corporation and principal shareholder therein which is not at the fair market value excluding transaction between the corporation and its subsidiary.

The report must specify the resolutions adopted by the general meeting that do not comply with the directors' recommendations on the matters set above. Furthermore, the resolutions of any extraordinary general meeting shall be presented.

Decisions of Company. Details must be provided regarding the company's resolutions as specified below:

91 The term 'distribution' is defined in the Companies Law as paying of a dividend or an undertaking to do so, directly or indirectly, and also acquiring, or providing the financing for the acquisition, directly or indirectly, by the company or by its subsidiary or by another corporation that it controls, of shares of the company or of securities that are convertible or exercisable into the company's shares, or redemption of redeemable securities which are part of the company's share capital, and including an undertaking to do each of the foregoing, all provided that the seller is not the company itself or another corporation fully owned by the company.

- Approval of actions of any company officer that involve: a conflict of interest between the performance of his function in the company and the performance of any other function, and his personal affairs; competition with the company's business; the exploitation of business opportunity of the company for a personal benefit; whereby such an action must be approved by the board of directors, and in certain circumstances also by the audit committee and the general meeting of the company. Such disclosure shall include the name of the officer and his position, the date of the action and its details, the date of approval of the action, a description of the procedures pursuant to which the action was approved, and the reasons for its approval;
- Any action listed above, which has not been approved, whether or not submitted for approval, including the name of the officer and his position, the date of the action and its details, the date of the decision, a description of the procedures that preceded its non-submission for approval or for its non-approval, and the reasons for same;
- An exceptional transaction[92] between the company and its officers and/or between the company and another person, in which an officer in the company has a personal interest (however (a) an officer in a parent company and also in a subsidiary under its complete control and ownership, shall not be deemed to have a personal interest in a transaction between the parent company and the subsidiary, only due to his serving as an officer in both; and (b) an officer in several subsidiaries that are wholly owned and wholly controlled by the same person shall not be deemed to have a personal interest in a transaction between aforesaid subsidiaries, only due to his serving as an officer of the contracting companies); and
- An exemption, insurance, or undertaking for indemnification, granted to an officer (general manager, chief business manager, deputy to the general manager, vice-general manager, any person performing aforesaid functions in the company, and also any director, or manager who is directly subservient to the general manager), which is in force on the date of the report.

This Authority has on various occasions indicated that it intends to materially modify the form and contents of the periodic reports, including, *inter alia*, the structure thereof, and has published from time to time drafts of certain proposals, in order to receive feedbacks and comments. For example, the Authority has indicated that it intends to replace the board of directors' report by a management report, focusing only on a company's state of affairs. Unless otherwise specifically indicated herein, all such proposals and initiatives of the Authority have not been formally adopted on the date of this publication and are therefore non-binding.

92 An exceptional transaction is defined in the Companies Law as a transaction that is not in the ordinary course of the company's business, a transaction not under market conditions or a transaction that is likely to have a material effect on the company's profitability, property or obligations.

Immediate Reports

Date for Submitting Immediate Report. An immediate report must be filed as follows:

- If an event became known to the corporation prior to 9:30 am on any trading day — not later than 1 pm on that same day; or
- If an event became known to the corporation at another time — not later than 9:30 am on the next trading day immediately following the date the event became known to the company.
- A corporation will be deemed to have become aware of the occurrence of an event as of the date one of the following persons has become aware of the occurrence of the event:
- The chairman of the board of directors of a corporation;
- Its general manager;
- Its chief business manager;
- The most senior officer in the field of the corporation's finances;
- The secretary of the corporation; or
- A person performing any of the abovementioned functions in the corporation even if his office is defined differently.

The immediate report shall specify the date and time at which the event occurred and the date and time at which the corporation first learned about its occurrence, and the details listed below.

In any event, the immediate report shall be filed before the information contained in it, in whole or in part, has been disclosed to the public by the corporation or by its senior officer. If the immediate report has been filed within the half hour prior to the opening of trading or during the hours in which trading takes place on the stock exchange on which the corporation's securities are listed, the corporation will neither publish nor cause the publication of part of or all of the information contained in the report, until the publication of the report at the distribution site (the Authority's web site, accessible to the general public, presenting the reports of the reporting parties).

Immediate Report upon Securities Authority's Demand. If the Securities Authority learns of an event, which does not require an immediate report in accordance with the Regulations, and the Authority believes such event is important for a reasonable investor considering purchase or sale of the corporation's securities, the Authority has the authority to instruct the corporation to file an immediate report regarding the event, within a period it determines.

Change in Corporation's Capital, Dormant Shares and Other Securities. If any change occurs in the corporation's registered or issued share capital, an immediate report shall provide details of all the changes in all classes of the share capital and the consideration paid or to be paid for the issued shares.

In the event a change in the number of shares in the issued share capital is less than one per cent of the corporation's issued share capital, the report will be made by means of a condensed report which will be submitted between the first and fifth of every month following the month in which such change occurred (termed: 'condensed report'). The condensed report shall provide details regarding each change separately. In the following cases a condensed report will be filed at the dates set out above for filing an immediate report:

- The cumulative change that has occurred since filing the previous condensed report amounts to one per cent of the corporation's issued capital;
- The effective date has arrived for confirmation of the ownership of shares in the company for the purpose of voting in a general meeting, or the effective date in relation to entitlement to interest, redemption, dividends' rights, benefits, or any other right; or
- The total cumulative change in the corporation's equity as a result of the increase of its issued share capital or its reduction since filing the previous condensed report is of at least NIS 1,000,000.

If dormant shares have been created in the issued share capital of the company or a change has occurred in their number or in the identity of their holders (termed: 'change'), details of such change will be provided in an immediate report, stating, *inter alia*, the following details:

- Name of the holder of the dormant shares;
- Name of the share;
- Date of the change;
- Form of the change — acquisition, including acquisition of shares other than in accordance with a special or full purchase offer as defined in the Companies Law, sale, forfeiture of a share that has been issued by the company and in respect of which the consideration that the shareholder undertook to pay for it has not been wholly or partially paid on the due date and in accordance with the terms and conditions stipulated for the same in an agreement or conversion regulations, or another change;
- If the change occurred by way of acquisition or sale, it will be stated whether it occurred in the course of trading on a stock exchange or outside of a stock exchange and, in the case of an acquisition by an issue being made, whether such issue was to the public or by way of an exercise of rights;
- The number of dormant shares which the holder held prior to and following the change;
- The percentage of the corporation's outstanding share capital held by the person holding dormant shares following the change;
- The percentage of voting power in the corporation vested in the person holding dormant shares following the change;
- The price at which the change was made and the total consideration in money. If the price, in whole or in part, was not paid on the date of the change, the

date on which the price or the balance is due shall be specified. If such payment was not made at the prescribed date, an additional immediate report will be filed, specifying such fact and the reasons therefor;

- If it was agreed that some or all the shares or the convertible securities will not be transferred at the time of the agreement regarding the change, the date stipulated for such transfer will be stated; if such transfer has not taken place at the stipulated time, an additional immediate report will be filed specifying such fact and the reasons therefor;
- If the change occurred as a result of the company acquiring its own shares as part of an acquisition plan, the immediate report regarding adoption of the acquisition plan will state the date of its submission and the portion of the plan implemented following the change. If there was a change in the number of debentures or warrants offered to the public according to a prospectus, the immediate report shall provide the details of the change. If the aforementioned change is less than one per cent of total debentures or warrants in the affected series, the report shall be made in the form of a condensed report.
- If the change in the number of the dormant shares is less than one per cent of the corporation's issued share capital and the aforementioned change is the result of an action taken by a member of an institutional reporting group that is managed or controlled by the reporting corporation, the reporting shall be made by means of a condensed report, subject to the foregoing exceptions; and
- Detailed particulars will be attached to a report, as previously stated, of the number of shares contained in the corporation's registered share capital, the number of shares contained in its issued share capital, and the number of shares as aforesaid after deduction of the dormant shares, differentiating between the number of shares which do not confer voting rights and the number of shares which do not confer any rights at all.

Changes Related to the Company. If the name of the company has been changed with the approval of the Registrar of Companies, details of such change and the date on which such change was registered with the Registrar will be provided in an immediate report. If a change has occurred in the corporation's address, telephone, and telefax numbers, or in the corporation's electronic mail address, details of such change will be provided in an immediate report. If the corporation has adopted a resolution to amend its articles of association and/or its memorandum of association, the complete text of such amendment and the date on which it becomes effective will be provided, and the text of the amended articles of association and/or memorandum of association (as the case may be) in its entirety will be attached.

If an application has been submitted to the court with regard to a change of the provisions of the memorandum of association or its revocation, an immediate report shall provide details regarding the application submission date, its main principles, and the court's decisions in relation thereto. If changes occurred in the company's shareholders' register, details of such change will be provided in

an immediate report, and an updated shareholders register shall be attached thereto. Notwithstanding the foregoing, if the cumulative rate of change in the nominal value of the shares that were added or subtracted from the shareholder register is less than one percent of the total nominal value of all shares included in the register, the change will be reported, once a month, in a report to be submitted on the second trading day of the month.

Changes in Terms of Trust Deed. If the trust deed (typically included as part of an offering of debentures) was amended, such amendment shall be detailed in a report, including the date of such amendment coming into effect, and the amended trust deed shall be attached thereto. If the trustee for the debentures has been replaced, or details regarding such trustee have been changed in comparison to those provided in the interim or annual report, such changed details and its date shall be provided.

Material Events in Life of Company. An immediate report will be published in respect of the material events as detailed below:

- Discrimination — If an application has been submitted to the court for the removal of or the prevention of discrimination (in which it is alleged that any of the company's affairs have been conducted in a manner that could be construed as involving oppression of some or all of the shareholders) except for an application whose effect on the company is negligible, details will be provided as to the date of submission of the application and its main principles, and decisions of the court pertaining to such application;
- A Public Company Becoming a Private Company — If the corporation has converted from being a public company[93] into a private company (meaning a company that is not public), details of the circumstances under which the corporation becomes a private company will be provided, and it will be stated whether the reporting obligations under Section 36 of the Law will continue to apply to it;
- Compromise or Arrangement (Settlement) — If an application is made to the court for a settlement by way of a compromise or arrangement between the company and its creditors or its shareholders, or between the company and a class of creditors or shareholders under Sections 350 or 351 of the Companies Law, except an *ex parte* application for a stay of proceedings order, such application shall be attached to the report and the following details and/or documents shall be provided and/or attached to it, as the case may be: (a) the date on which the application was submitted to the court and its main principles and the form of the notice that was published as required by law; (b) the main principles of the recovery plan, as required by law, that has been submitted to the court, if submitted; (c) additional applications submitted to

93 A company whose shares are listed for trading on a stock exchange or that have been offered to the public under a prospectus pursuant to the Securities Law, and are held by the public.

the court in connection with the application for compromise or arrangement that are likely to have a substantial effect on the corporation, and the date of submission of such applications as well as their main principles; (d) granting of an order of stay of proceedings or an order for the transfer of assets, as the case may be; (e) appointment of a functionary by the court and his powers; (f) a decision to convene a meeting of creditors or of shareholders, as the case may be; (g) results of the creditors or shareholders' meeting, as the case may be; and (h) the court's decisions.

- Submission of an Application to Approve a Distribution[94] — If the corporation has submitted an application to the court to approve a distribution pursuant to Section 303 of the Companies Law,[95] details will be provided of the date of submission of the application to the court and the form of notice that was published and details as to the decisions of the court in respect of the application;
- Application for Winding up the Corporation or appointment of functionary — If an application has been submitted to the court or to the Head of the Execution Office, as the case may be, to issue an order for the winding up of the corporation or for the appointment of a receiver, liquidator, temporary liquidator, trustee, special manager, or other functionary (termed: functionary), an immediate report shall specify the date thereof and its main points, except an application made on negligible grounds; submission of additional applications to the court or to the Head of the Execution Office, as the case may be, their main points, and the date of the submission, except applications in proceedings based upon negligible grounds and in respect of which no report has been submitted; appointment of a functionary by the court or by the Head of the Execution Office, as the case may be, and his powers; rulings issued by the court or the Head of the Execution Office, as the case may be, except a ruling dismissing an application, the grounds for which are negligible or the dismissal of such additional applications made in proceedings based upon negligible grounds, and in respect of which no report was submitted; or if a functionary has submitted a report to the court or to the Head of the Execution Office, as the case may be, details will be given of the main points of the

94 Paying a dividend or a binding commitment to do so, directly or indirectly, as well as acquisition or providing financing for the acquisition, directly or indirectly, by a company or by its subsidiary or by another corporation that it controls, of the company's shares or securities that are convertible into shares of the company or that can be realised as company shares, or redemption of redeemable securities which are part of the company's share capital, and including an undertaking to do each of the foregoing, all provided that the seller is not the company itself or another corporation fully owned by the company.

95 A distribution that does not meet the conditions of the profit test, namely, a distribution that is not made out of the company's profits as defined in the Companies Law, but does comply with the requirements of the solvency test, namely there is no reasonable concern that payment of a dividend will prevent the company from satisfying its existing and foreseeable obligations as they become due.

report submitted as aforesaid, stating the place and times at which it can be reviewed; and

- Merger — If the board of directors of the corporation resolved to effect a merger, an immediate report shall include the following details: the merger proposal — a joint proposal to approve a merger which has been drawn up jointly by the boards of directors of the merging companies, after the merger has been approved by each of the boards of directors, and resolutions of the general meeting of the shareholders and of class shareholders' meetings. If the vote has taken place at a general meeting of a merging company whose shares are held by the other merging company or by a person who holds 25 per cent or more of any class or the means of control in the other merging company,[96] the following details will be included: the total amount of shares that participated in the vote, the number of shares that voted in favour and against the proposal, and the percentage of those in the total number of all the shares that were counted for the purpose of the vote, making the requisite distinction between shareholders counted as belonging to the other merging company, the holder, or any person acting on their behalf, including their relatives or corporations under their control, and shareholders who are not counted or defined as above; notwithstanding the aforementioned, the approval of the general meeting of shareholders for a merger transaction is not required at a target company fully owned and controlled by the receiving company, or at the receiving company, provided that all of the following has occurred: the merger does not involve a change in the receiving company's memorandum or articles; the receiving company does not issue, as part of the merger, more than 20 per cent of the voting rights in the company, as a result of which no person from the company must become a controlling shareholder of the receiving company;[97] the receiving company's shares are not held by the target company or by another person holding 25 per cent or more of any class or the means of control in the target company; and no person holds 25 per cent or more of any class or the means of control in the merging companies. If a creditor has made an application to the court to delay or prevent the merger based upon a reasonable suspicion that, as a result of the merger, the absorbing company (into which all the assets and liabilities of the merging company will pass following the merger, and which will thereafter be liquidated) will not be able to meet the merging company's obligations, the report shall provide details regarding the date of the filing of the application and its main arguments; rulings of the court; notification of the Restrictive Trade Practices Controller (Israeli Anti-Trust Authorities), as defined in the

96 A person may not be deemed as holding the other merging company if the holdings derive solely from holding shares in the merging company.

97 For this purpose, securities convertible or exercisable into shares, held by a person or deemed to be issued to a person as part of the merger, must be deemed as if converted or exercised.

Restrictive Trade Practices Law, 5748-1988; and details as to the completion and registration of the merger with the Registrar of Companies.

Immediate Report Regarding Approval of Acquisition Plan. If the corporation[98] or a corporation controlled by it has decided, according to a plan, to acquire[99] its own securities which were previously offered to the public by means of a prospectus, the corporation will submit an immediate report that will state any detail that is likely to be important to a reasonable investor and such report will include the following details:

- The class of security to be acquired under the acquisition plan;
- The identity of the acquiring corporation and its affiliation with the reporting corporation;
- The planned date for commencing implementation of the acquisition plan, the estimated timing of future acquisitions and the period for the execution of the plan;
- The date on which the acquisition plan was approved by the board of directors;
- The board of director's reasons for executing the acquisition plan;
- The total estimated cost of the acquisition plan or the quantity of securities that are likely to be acquired as part of the acquisition plan;
- The tax implication of executing the acquisition plan for the company and for the holders of its securities;
- Sources of funding for executing the acquisition plan. In case the acquisition plan is intended to be financed with a loan, the terms of such loan shall be provided;
- The manner in which the acquisition is to be performed – acquisition on the Stock Exchange, acquisition through a tender offer, acquisition by means of a swap of securities in an arrangement, acquisition by instructing third parties to collect securities on the market or any other method of acquisition to be described;
- Details of the acquisition plans approved during the three years prior to the date of the report; the aforementioned details may be provided by incorporation by reference of the reports that describe the aforementioned plans; and

98 This provision applies to all types of corporations except for an issuer of index products.

99 Acquisition for this purpose shall mean acquiring, or providing the financing for the acquisition, directly or indirectly, by the company or by its subsidiary or by another corporation that it controls, of company's securities, or redemption of redeemable securities which are part of the company's share capital, including an undertaking to do same, all provided that the seller is not the company itself or another corporation fully owned by the company.

- If the acquisition plan involves shares or securities convertible into shares, the following details will also be provided: (a) The corporation‘s profits (as defined in Section 302 of the Companies Law[100]); (b) Whether the acquisition according to the plan is expected to materially affect the holdings of principal shareholders.

If the acquisition plan is amended or canceled before it was completed, the corporation will submit an immediate report which will state the reasons for the change or the cancellation, as well as the effect of the change or cancellation on the details provided as aforementioned.

It is presumed that one of the following is an acquisition according to a plan: (1) Acquisitions carried out according to a decision of the board of directors; (2) Acquisitions effected in proximity to each other.

A company acquiring its own securities may, in certain events, be liable for violation of prohibitions upon use of insider information. In order to address such concern the Authority published in 2010 a ‘Safe-Harbor’ directive intended to reduce exposure to such violations.[101]

Right to Purchase Shares. If the corporation grants rights to purchase shares, an immediate report shall specify the class and number of shares, the consideration therefor and for the undertaking to issue them, and the expiry date of the right to purchase them.

Holdings of Principal Shareholder or a Senior Executive. If any change occurs in the number of all classes of shares or other securities held in the corporation, or in any material subsidiary or affiliate thereof, by a principal shareholder of the corporation, or if a contract is signed the execution of which will cause such change, an immediate report shall describe such change to the best knowledge of the corporation, including the following:[102]

- Name of the principal shareholder and his identity number;

100 The corporation’s profits for this purpose shall mean a profit balance or profits accrued in the last two years, whichever is the larger amount, all according to the last adjusted audited or reviewed financial reports prepared by the company, subtracting earlier distributions if they were not already subtracted from surpluses, provided that the date of such financial reports is not more than six months prior to the distribution.

101 For further details see ‘Insider Information’ hereinbelow.

102 Where regulations under Section 36 require a corporation to disclose in its reports details of the holdings of its securities principal shareholders or by senior corporate officers therein, or other details concerning the said principal shareholders or senior corporate officers, including changes in such holdings, such principal shareholders or senior corporate officers are required to notify the corporation of such details and within such period so as to enable the corporation to fulfill its aforesaid reporting obligations.

- Name of the security;
- Date of the change;
- Method by which the change was made: purchase, sale, including selling short, signature of a loan document, decrease due to partial or complete redemption of certificates of indebtedness, conversion, or other change;
- If the change was made by way of purchase or sale, including selling short, whether it was made in the course of stock exchange trading ('on the floor'), or outside a stock exchange ('off the floor') and, if by acquisition by way of issuance, if the issuance was to the public or by way of an exercise of rights;
- Number of securities that the principal shareholder held prior to and subsequent to the change and its proportion out of the total securities of the same class;
- The price at which the change was made and the total amount of monetary consideration. If part, or all, of the price was not paid at the time of the change, the date on which payment of the price or the balance was supposed to have been made, will be stated. If payment was not made at the stipulated time, a further immediate report will be submitted in which this fact and the reasons therefore will be stated;
- If the executed contract is an option agreement to purchase or sell a corporation's securities, details regarding the exercise price and exercise period specified therein as well as the identity of the other party to the contract in case he is a principal shareholder as well, shall also described;
- If it has been agreed that some or all of the shares or other securities will not be transferred on the date of the agreement concerning the occurrence of change, the date stipulated for such transfer will be stated; if the transfer has not taken place on the stipulated date, a further immediate report will be submitted in which this fact and the reasons therefore will be stated;
- The percentage of the corporation's issued share capital held by the principal shareholder following the change and also the same on a fully diluted basis;
- The percentage of voting power in the corporation that is held by the principal shareholder following the change and also the same on a fully diluted basis;
- If the change was made by way of signing a loan document, details will be provided as of the manner in which the loan shall be terminated, whether by way of returning the loaned securities to the lender or by way of selling the loaned securities if the borrower is not returning the loaned securities to the lender; and
- Whether the reported securities are dormant shares or securities convertible into dormant shares.

Notwithstanding the foregoing, the corporation shall report, to the best of its knowledge, of the cumulative monthly change in the Principal Shareholder's holdings of its securities, excluding changes of the Principal Shareholder's "Nostro" account, if the change applies to securities of the corporation held by a

Principal Shareholder who is a member of a reporting institution group or holding via members of the reporting institution group controlled or managed by the Principal Shareholder.

Once a month, on the fifth trading day in the month, the corporation shall file a report containing details of the principal shareholders therein and of their holdings of the corporation‘s securities (hereinafter: “Status Report”) as of the end of the last trading day in the previous month (hereinafter: “ the Validity Date”), unless on the said Validity Date there was no change in the holdings of the principal shareholders in comparison to their holdings as described in the previous Status Report. Notwithstanding the foregoing, if the cumulative change in the holdings of a Principal Shareholder via members of a reporting institution group controlled or managed by the Principal Shareholder, since the later of the submission of the previous status report or the submission of the last immediate report under this provision, has amounted to at least 1% of the corporation‘s issued and paid-up capital, or to at least 5% of the debentures series’ total nominal value, as the case may be, and the next status report is not due yet, the corporation shall submit an immediate report.

If a person has become a principal shareholder in the corporation, the following information must be provided: his name, address, and the number of all classes of shares or convertible securities held by him, to the corporation’s best knowledge, in the corporation or any of its subsidiaries or affiliates, as well as details relating to the act which resulted in the person becoming a principal shareholder in the corporation. The above mentioned provision shall apply also to a corporation that has become a principal shareholder in itself.

If a person has become a principal shareholder in a corporation by virtue of the corporation’s shares having become dormant shares (as defined above) or due to the purchase of a corporation’s debentures by its subsidiary, such change will be stated not later than when such change was made in such person’s holdings, subsequent to which he will become or remain a principal shareholder in the corporation.

If a person ceased to be a principal shareholder in a corporation, the date on which such status ceased, as well as details regarding the event as a result of which such status ceased, will be stated.

Changes in Senior Executives. If a senior officer of the corporation ceases to serve in his position,[103] an immediate report shall detail his name, the position

103 In accordance with the Authority’s directives, like other material events, when a notice regarding the termination incumbency of the CEO or other senior officer in the company (as long as it is deemed to be a material event), has been given to the company, the company must publish an immediate report, whether the termination comes into effect immediately or in the future, whether the decision of the termination is conditional or whether its absolute.

terminated, the date of termination, whether he will continue to be a principal shareholder or senior officer in the corporation, and, to the corporation's best knowledge, one of the following: the circumstances involved in the termination which should be brought to the knowledge of the corporation's shareholders, or a statement that the termination does not involve such circumstances.

In the event that a director ceased to serve in his position, then in addition to the required details mentioned above, the immediate report shall specify whether this director was considered by the company as having accounting and financial expertise, to uphold the minimum number determined by the board of directors, and whether as a result of the director's retirement, the number of directors having accounting and financial expertise has decreased under the minimum.

In the event that a director in a public company ceased to serve in his position, and the articles of association of the company include a provision with respect to the number of independent directors, then in addition to the required details mentioned above, the following details shall be specified in an immediate report:

- Whether such director is deemed to be an independent director for the purpose of fulfilling the provision with respect to the number of independent directors; and
- Whether, due to the cessation of a director's services, the number of independent directors serving on the board of directors decreased from the minimum required for fulfilling the provision with respect to the number of independent directors.

If the corporation appoints a senior officer, an immediate report shall provide the details concerning him as set forth in the Regulations. If the corporation's articles of association included a provision regarding the amount of independent directors, the report shall specify whether following the appointment of the senior officer the amount of independent directors serving on the board of directors of the corporation is less than the amount required by such provision. If a director was appointed not by the general meeting, then, in addition, an affidavit signed by such a director shall be attached to the immediate report.

Matters That Deviates from Corporation's Ordinary Course of Business. An immediate report shall provide details of any event or matter that deviates from the corporation's ordinary course of business due to its nature, scope, or potential consequences, and which has or is likely to have a material effect on the corporation, and as to any event or matter that could have a significant effect on the price of the corporation's securities.

If an event or matter described above is the corporation's undertaking to purchase a significant asset, the corporation shall submit an immediate report at every stage of the transaction commencing from the negotiations phase, containing details of the asset to be acquired, and of special risk factors thereof.

Notwithstanding the foregoing, a corporation may delay the submission of an immediate report of an event or matter, in whole or in part, if disclosure of such

information is likely to prevent the completion of the underlying transaction or to substantially detrimentally affect its terms and conditions, provided that information about such an event or matter has not yet been made public.

However, a corporation is not entitled to delay submission of an immediate report in the period commencing five days prior to the last date for converting the corporation's convertible securities. If the corporation has delayed the submission of an immediate report prior to the commencement of this period, the corporation will submit the details no later than five days prior to the last date for converting such convertible securities.

The Regulations leave to the company's discretion whether any event or matter that has occurred requires disclosure, while supervision and control over the manner in which such discretion is exercised by the company, vests with the Securities Authority, subject to a number of exceptions detailed above and below.

This legislative model is in the form of a balance of interests (which is based on cost-benefit considerations) between the interest of the public in immediate disclosure, and the interest of the corporation in taking action to complete an action or transaction as stated above:

- After the removal of the impediment to the submission of an immediate report, the corporation will submit an immediate report about the event or matter and will also state the reason for the delay and the date and time at which the impediment to the submission of the report was removed;
- If the submission of an immediate report regarding an event or matter is being delayed by the corporation, and information regarding such event or matter has nevertheless been made public, the corporation is required to submit an immediate report about such event or matter and to also refer in this report to the correctness of the information that has already been made public;
- In relation to a delay in publication of an immediate report, the date of removal of the impediment or the date on which the information was first made public, as the case may be, will be deemed to be the date on which the corporation first learned of the event; and
- These provisions will not apply to an event or matter that is well known within the public domain, unless it has a special effect on the corporation's business.

Failure to Achieve Objectives in Use of Proceeds. If one or more of the objectives presented in a prospectus as its use of proceeds has not been achieved, or if the timetable presented therein has not been met, the corporation shall report the same in an immediate report and provide the reasons therefore.

Convening Meetings of Security holders. If a meeting of the securities holders of the corporation is convened (including general meetings of shareholders, a class meeting, a meeting of holders of options, a meeting of holders of debentures, and any other meeting of holders of the corporation's securities, excluding a meeting

of the shareholders of a corporation whose shares are not held by the public), the corporation shall submit an immediate report stating the following details:

- The type of meeting;
- The place where the meeting is being held;
- The date and time of the meeting;
- Details of matters on the agenda;[104]
- Place and times for review of proposed resolutions;
- The majority required for each issue on the agenda, if it is not an ordinary majority;
- The date for determining the entitlement of the shareholders to participate and to vote at the general meeting;
- The legal quorum for the holding of the meeting; and
- If the agenda of the meeting included a proposal to appoint a person to a directorship in the corporation, details listed under Directors of the Corporation above, and pertaining to him should be presented.[105] The notice convening the meeting and the applicant's signed statement to serve as a director as required under Sections 224(A) and 241 of the Companies Law also must be provided.

In addition, the Companies Regulations (Notice of a General Meeting and a Class Meeting in a Public Company), 5760-2000, stipulate further information to be detailed in a notice concerning the convening of a general meeting, including the address of the distribution site and the stock exchange's site, in which form the voting instruments and opinion statements can be found, details regarding the procedure of voting on a voting instrument, and dates regarding the transfer of the voting instruments and opinion statements.

A company that has a web site shall also publish the said notice on its web site. An immediate report pursuant to the Periodical and Immediate Reports Regulations shall be filed on the day on which the date and agenda of the meeting are determined. If the meeting is postponed, an immediate report shall be submitted, stating such fact, and the information specified hereinabove provided with regard to the postponed meeting; the information may be provided by way of reference to the report published concerning the convening of the meeting being postponed.

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104 With regard to each matter, the report shall provide a description of its nature, while specifying the main facts required for proper understanding of such matter. The report shall also provide the text of each proposed resolution or a brief description of its principal points.

105 If the subject of the proposal is the extension of the director's term of service, the corporation is authorised to include the details by means of reference to the last periodic report submitted by it, provided that no change had occurred in such details reported in the periodic report.

These provisions will not apply if an immediate report is submitted on the convening of a general meeting pursuant to the certain specific Securities Regulations.[106]

Votes in Writing and Notices of Position. The immediate report must include the notices of position and voting papers which are required to be filed with the Securities Authority by virtue of Section 89 of the Companies Law and the regulations promulgated thereunder, on the dates which are determined in the aforementioned regulations.[107]

Results of Meeting. Resolutions adopted by the general meeting will be presented in an immediate report. In the event that the meeting adopted resolutions requiring special majorities, the following details also must be presented: the total amount of the shares which participated in the vote, the number of the shares which voted for the proposal and against it and the percentage of these out of the total of all the votes which were included in the vote count, with a distinction between the controlling shareholder or a party on its behalf and those who are not the controlling shareholder or a party on its behalf; and every other distinction between the shareholders, which is required to be made in terms of establishing that the proper majority has approved the resolution.

Recent directives of the Authority impose additional requirements with regard to presenting the results of general meetings adopting resolutions requiring certain special majorities, which include an immediate report also specifying, to the best of company's knowledge, the vote of the following shareholders: (i) principal shareholders; (ii) executive officers; and (iii) institutional investors.[108]

Recommendations and Resolutions of Directors. The immediate report shall present the directors' recommendations to the general meeting and their resolutions that do not require the general meeting's approval at the time of their adoption, concerning:

- A distribution as defined in the Companies Law — along with an indication of the balance of the profits within the meaning thereof in Section 302 of the Companies Law, prior to and following the distribution. The report also must specify the examinations made by corporation's board of directors with regard to compliance of the distribution with the requirements of the profit test and the solvency test, and its approval with regard to same;

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106 The Securities Regulations (Transaction between a Company and its Controlling Shareholder), 5761-2001, or in accordance with the Securities Regulations (Private Offering of Securities in a Listed Company), 5760-2000.

107 See additional details below under '*Voting Instruments and Opinion Statements'*.

108 For the purposes of this directive 'institutional investor' means (i) management companies, with regard to the investments made for pension funds managed by it; (ii) insurers, with regard to investments held against interest-dependent liabilities; and (iii) managers of investment trust fund.

- Distribution of bonus shares;
- Changes in the corporation's registered or issued share capital;
- Amendment of the corporation's memorandum or articles of incorporation;
- Redemption of redeemable securities and early redemption of debentures;
- Exercise of a right reserved by the corporation in its prospectus to change the Use of Proceeds of securities offered under such prospectus, including the amounts or the timetables thereof;
- An extraordinary transaction between the corporation and a principal shareholder, excluding transactions between the corporation and its subsidiaries; and
- An initial determination or a change of the minimum required number of directors with accounting and financial expertise, and the reasons for such initial determination or change, as the case may be.

The recommendations of the directors to the extraordinary meeting shall also be presented by means of immediate report.

Decisions of Company. An immediate report shall provide details regarding the following company's resolutions:

- Approval of actions under Section 255 of the Companies Law (an action of an officer that involves: a conflict of interest between the performance of his duties in the company and his personal affairs, or that involves competition with the company's business, or that involves the exploitation of a business opportunity of the company with the object of obtaining a benefit for himself or for another person, whereby such an act must be approved by the board of directors, and in certain cases also by the audit committee and the general meeting of the company), giving fully itemised details of the name of the officer and his position, the date of the action and details thereof, the date of approval of the action, a description of the procedures pursuant to which the action was approved, and the reasons for its approval;
- Any action described above, which has not been approved, whether or not it was submitted for approval, with itemised details of the name of the officer and his position, the date of the action and its details, the date of the resolution, a description of the procedures that preceded its non-submission for approval or for its non-approval, and the reasons therefore;
- Extraordinary transactions which require approvals pursuant to Section 270(1) of the Companies Law (certain affiliated party transactions);
- Engagement of a company with its general manager or with a party carrying out that function within the company, even if he holds a different title, with respect to the terms of his employment or service; and
- Grant of indemnification to an officer with regard to liabilities or expenses imposed on him or which he incurred due to his actions performed by virtue of his being an officer in the company.

Approval of the audit committee and the board of directors of a transaction or agreement, effected by the company, pursuant to the Section 270(3) or (4) of the Companies Law (certain affiliated party transactions), which does not require the approval of a general meeting in accordance with regulations 1–1B of the Companies Regulations (Easements in Transactions with Principal Shareholders) 5760-2000, as well as details pertaining to:

- The principal points of the transaction;
- The board of director's and the audit committee's arguments in favour of approving the transaction or the agreement; and
- The right of shareholders to object to the easement as detailed under Regulation 1C of the Companies Regulations (Easements in Transactions with Principal Shareholders) 5760-2000.

Details of a transaction with a controlling shareholder or of a transaction that the controlling shareholder has a personal interest in its approval, including the main points of the transaction, and the details of the organ which approved the transaction and the summary of his reasons for approval.

Transactions Involving Valuations. Following a transaction carried out by a corporation (if carried out within two years following the date the valuation had been first attached to the report of a corporation, including the professional opinion), whose derivative value is substantially different from the one provided under the valuation, the corporation should submit an immediate report containing details pertaining to the differences between the derivative value of the transaction and the value provided under the valuation, accompanied by explanations of the said difference.

Duty to Update. Following a report submitted by a corporation pertaining to an event or issue ('original report') that could occur at a later date ('probable event or issue'), the corporation is required to submit a report pertaining to all material changes that occurred in relation to the probable event or issue; if the original report states an anticipated date for a probable event or issue, the corporation should submit an immediate report pertaining to the state of probable events or issues, on such anticipated date.

Interim Financial Statements

Date of Filing of Quarterly Reports. The corporation shall file a quarterly report with the Securities Authority within two months following the report date, provided that it is filed within three days of the date on which the accountant of the corporation signed the review report that relates to the interim financial statements. The execution date of the quarterly report shall not precede the date on which it is filed with the Securities Authority and the Stock Exchange by more than three days.

Update of Information Included in Periodic Report. A quarterly report shall specify any material change that occurred during the reported period in the

business of the corporation related to any matter that should be described in the periodic report.

Principles for Preparing Statement. The interim report shall be prepared in accordance with generally accepted accounting principles of financial reporting for interim periods and shall duly present the corporation‘s financial status, its performances and cash flow and the changes in its financial status and its equity during the reporting periods included in the interim report. Each amount therein shall be presented together with the corresponding amount for the corresponding period of the previous reported year and for the whole reported year; the currency of the intermediate statements must be as stipulated under Regulation 4 of the Securities Regulations (Preparation of Annual Financial Statements), 5753-1993; The corporation will include in its interim financial statements an express and unconditional declaration regarding its full compliance with generally accepted accounting principles with regard to financial reporting for the interim periods.

The interim statement shall present the financial report as of the report date. A total profit statement, report on changes in equity capital, and cash flows shall be presented as follows: for the first quarter - in the first-quarter interim statement; for the second quarter and the six-month period ending on the date of the second-quarter statement - in the second-quarter interim statement; for the third quarter and the nine-month period ending on the date of the third-quarter statement - in the third-quarter interim statement.

Comparative Statements. Each amount in the balance sheet shall be presented together with the corresponding amount in the financial report for the corresponding quarter of the reported year and for the whole reported year.

Required Details. The interim report shall provide disclosure of every change in accounting policy, every updated estimate and correction of a mistake made during the reported period and shall include the following details:

- If, during the reported period, the corporation changed the accounting policy that it had implemented during the previous reported periods, the change shall be explained and the reasons therefor shall be presented, including the reasons why the implementation of the new accounting policy provides more reliable and relevant information, and the amounts of the adjustment for the reported period in which the change was made and for all previous reported periods included in the interim report shall be specified; and
- If a material mistake in the previous period was corrected by presenting it again in the interim financial statements, then the interim financial statements in which the error was corrected shall provide all the details required for understanding the mistake and its correction.

If during the reported period the corporation changed an accounting estimate, the report shall specify the change and the reasons therefor, the amount of the change in the estimate, which has an effect during the current reported period or

is expected to have an effect in future reported periods, excluding disclosure of the effect in future periods when it is not feasible to estimate the effect. If it is not feasible to assess the effect of the change in the estimate on future reported periods, such fact and the reasons therefor shall be disclosed.

The aforesaid details shall be presented separately in the notes, and there is no requirement to include in the report any information which, under the circumstances, is immaterial.

Attaching Statements of 'Included Company'. A corporation shall attach to its quarterly report the interim financial statements of an included company, for the same quarter, if: (i) the corporation's investment in the included company constitutes, in its absolute value, 20 per cent or more of the total assets in the corporation's financial report; or (ii) the amount included in the profit or loss due to the corporation's investment in the included company constitutes, in its absolute value, 20 per cent or more of the absolute value of the corporation's profit or loss; or (iii) the included company has significant importance for the corporation's business or operations in their existing formats, or in future formats intended for them; or (iv) any of the requirements in subsections (i) or (ii) was met in the previous reported year and the same is anticipated in the next reported year as well; (v) the company became the corporation's included company after the date of the corporation's financial report, and requirement of subsection (iii) was met.

Notwithstanding the foregoing, interim financial statements of an included company shall not be attached to corporation's quarterly report under the following circumstances: (i) the included company's reports are insignificant in relation to the corporation's reports; (ii) none of the requirements listed in subsections (iii) through (v) hereinabove is met, none of the requirements listed in subsections (i) or (ii) hereinabove was met during the previous reported year, and the same is anticipated in the next reported year; (iii) after the date of the corporation's financial report, the company ceased to be the corporation's included company.

Interim financial statements of an included company will be arranged in accordance with Regulation 23 of the Financial Statements Regulations,[109] as follows: (i) the statement will be prepared in accordance with the generally accepted accounting principles; (ii) in the event they are not presented in the same currency as the corporation's reports, the exchange rate between the currency of the included company's reports and the currency of the corporation's reports shall be specified, as of the date of the financial statements, and any change in such rate during the reported year shall be indicated; (iii) the statements shall be audited in accordance with Israeli accepted auditing standards, or in accordance with the international auditing standards or in accordance with a set of comprehensive foreign auditing standards; (iv) an

109 Securities Regulations (Annual Financial Statements), 2010.

auditor‘s report shall be attached to the statements, indicating the accounting rules in accordance with which the statements were prepared and the auditing standards in accordance with which the statements were audited; (v) if the language of the statements is neither Hebrew nor English, translation of the statements into Hebrew (including auditors’ report) shall be attached, as well as a translator’s certificate confirming the accuracy of the translation and the translator‘s consent to including the translation and the certificate in the reports; if the duly signed translation into Hebrew of the financial statements has been attached, the statements in the original language are not required to be attached.

If the attachment of the interim financial statements of an included company was not preceded by the attachment of its annual financial statements, the interim financial statements of the included company shall also include a note regarding the accounting policy that was applied with regard to its recent annual financial statements.

The corporation’s quarterly report shall provide summarized information regarding an included company, for each of the periods included in the corporation‘s consolidated financial statements, distinguishing between summarized information on the included company‘s financial status and summarized information on the results of its activity, all according to Regulation 24 of the Financial Statements Regulations, *mutatis mutandis*.

Attaching Statements of Company Guaranteed under Unlimited Guarantee. The Regulations specify the duty to attach the interim statements of a guaranteed company, as defined in the financial statements.

Pro Forma Data. The company shall enclose to the quarterly report a *pro forma* report in event that a *pro forma* event occurred during the interim period, following the interim financial report date and up to the financial report approval date or if there is high probability that a *pro forma* event will be completed within a three-month period following the interim financial report approval date, provided that the completion of such event is not dependent on the fulfillment of any material conditions.

Notwithstanding the above, if a *pro forma* event occurred following the interim financial report date and up to the financial report approval date, or if there is high probability that a *pro forma* event shall be completed within the three-month period following the interim financial report approval date and the completion does not involve the fulfillment of any material conditions, the company shall publish the *pro forma* report through an immediate report 90 days from the day of the *pro forma* event or its completion, as the case may be, or through a periodic or quarterly report for the period in which the pro-forma event took place, whichever is earlier.

The interim Financial Statements, shall also include, alike the annual report, *mutatis mutandis*, report on the effectiveness of internal auditing of financial reporting and disclosure, separate financial report by the corporation and report on debenture inventory according to date of redemption.

Approval and Signature of Statement. The report shall be executed in the name of the corporation by the chairman of the board of directors, the general manager, and the most senior financial officer, or by a director who was authorized by the board of directors to execute the financial statements for a particular date instead of any of these executives.

The signature date, the names of the signatories, and their positions in the corporation will be indicated in the financial statements. The periodic report shall be submitted by electronic media (Internet) to the Securities Authority, pursuant to the provisions of the Securities Regulations (Electronic Signature and Reporting), 5763-2003, as further detailed hereunder.

Auditor's Review. A review by an auditor shall be attached to the interim report, confirming that the statements have been prepared in accordance with the Regulations. The auditor shall confirm preparation of the review by his signature and shall specify the date thereof.

Board of Directors' Report for Interim Period. The board of directors' report for the interim period,[110] containing explanations with respect to events and changes occurred in the corporation's business during the interim period and the cumulative period commencing the end of the last reporting year and ending on the date of the statement, provided that the effect of such events and changes on the data in the interim financial statements is significant, shall also be attached to the financial statements.

The scope of the board of directors' report for the interim period shall be limited and it shall be prepared based on the assumption that its readers also hold the board of directors' report for the previous reporting year and therefore there is no need to repeat the information which had already been included therein; the interim board of directors' report which is submitted by a corporation which has offered securities to the public for the first time, and has not yet published a board of directors' report, shall be prepared based on the assumption that its readers hold the prospectus.

An interim period directors' report must be prepared in accordance with the following provisions: explanations shall be provided on each of the issues as set

110 This requirement is not applicable to banking and insurance corporations as well as to information in the periodic report of a corporation that had consolidated fully or on a relative basis, a banking corporation, as far as the information relates to the banking corporation; or to information in the periodic report of a corporation that had consolidated fully or on a relative basis, an insurer, as far as the information relates to the insurer; or to information within the periodic report of a corporation that had consolidated fully or on a relative basis a corporation which comes under the provisions of Chapter C5 of the Securities Law ('consolidated corporation'), providing that the information: (a) pertains to a consolidated corporation and (b) is not required under disclosure requirements of the foreign law which applies to the consolidated corporation.

forth with respect to the annual board of directors' report, and shall include comparisons to the interim periods the statements for which were included as comparison figures in the interim financial statements. Expression shall be given to:

- Seasonal effects on the results of the corporation's operations;
- Extraordinary or one-time events;
- Events that may indicate financial difficulties; and
- Explanation of issues to which the corporation's auditor drew attention in his letter of review of the interim financial statements.

Reference must be made to the material changes that occurred in determination or recommendation of payments to each of the five persons receiving the highest salaries in the corporation among the senior officers, and explanations shall be provided for the reasons of the board of directors on which the determination or recommendation of such changes were based. Reference shall also be made to events that occurred after the status report date which are mentioned in the interim financial statements.

The report must include reference to very material changes which have taken place during the interim period and during the cumulative period commencing on the end of the last reported year and ending on the day of the report, in relation to exposure to market risks and to ways of dealing with them as specified above, *mutatis mutandis*.

If the board of directors changed its determination pertaining to the minimum number of directors with accounting and financial expertise, during the reported period, the change should be stated together with the board's reasons for the change. If the number of directors with accounting and financial expertise has fallen below the minimum number, the reasons should be stated, along with the actions the company is planning to take to comply with the minimum number and the proposed timetable therefore.

The report of the board of directors will be drafted in a clear and comprehensible manner and it will be divided into sections as specified above corresponding to the annual report of the board of directors, but the board of directors is entitled to combine the explanations in matters or in subjects which are connected to each other, if the board believes this will contribute to the clarity of the board of directors' report.

With respect to a corporation which prepares consolidated financial statements, the board of directors' report shall relate to such statements. The board of directors' report shall be approved by the corporation's board of directors simultaneously with the approval of the interim statements, and shall be executed by the chairman of the board of directors, or another director authorised by the board of directors for that purpose, and the general manager or anyone in the corporation fulfilling such position, even if his title is different.

A material valuation applied as a basis for stipulating reported values in a quarterly report, including a stipulation that there is no need to change reported values in the report, should be attached by the corporation to the quarterly report and provisions of Regulation 8B, as stated above, shall apply to the valuation. If the corporation believes that a substantial change in value of property has occurred, as to which a valuation was included in the report, an updated valuation is required. Declarations of company's officers are required to be attached to the annual and interim financial statements and board of directors' report of a public company.

Periodic and Immediate Reports of Foreign Corporation. A foreign (non-Israeli) corporation whose securities are registered for trading on the Stock Exchange in accordance with a listing document, must submit to the Securities Authority and to the Stock Exchange reports or notices in accordance with the rules of double listing, for so long as its securities are publicly held, provided that, immediately prior to the registration for trading, reporting obligations did not apply to it in accordance with the Securities Law.

As determined in the rules of double listing, provisions of Chapter F of the Securities Law, by virtue of which the reporting regulations were enacted, focusing on the periodic and the immediate reporting obligations which have been reviewed above, do not apply to a foreign corporation (subject to certain exceptions).

Reports and notices of a foreign corporation will be drawn up in accordance with the reporting regulations of a foreign corporation[111] and they will be submitted to the Securities Authority and to the Stock Exchange.

In the event that the foreign corporation is obliged to submit a report which it has submitted or published to investors in its securities, listed for trading on a foreign stock exchange, it will submit a copy, containing an original signature of the report which has been submitted or which has been published outside of Israel as mentioned.

Documents which the foreign corporation has originally published or has submitted in English may be submitted in the original language. The reports and the notices will be signed by the corporation. Periodic and interim reports of a foreign corporation will be submitted by way of a reporting document, including, *inter alia*, the name of the corporation and the details listed below:

- Expanded contact details, the ticker symbol of the securities of the corporation on foreign stock exchange, the name and details of the person in the corporation in charge of maintaining the contacts between the corporation and the entity supervising or enforcing the foreign law, and the name and details of the person in the corporation who performs such function regarding the Authority; and

111 Securities Regulations (Periodic and Immediate Reports of a Foreign Corporation), 5761-2000.

- An annual report, a semiannual report or a quarterly report, as the case may be, which must be submitted or published under the foreign law.

The reporting document will be submitted upon the earlier to occur of (i) prior to a date which is determined for the submission or for the publication of the periodic report, the semi-annual report, or the interim report, as the case may be, in accordance with the foreign law, or (ii) a date it was published or reported to the holders of the corporation's securities listed for trading on a foreign stock exchange.

In the event that the periodic report, the semi-annual report, or the interim report has been submitted or has been published outside of Israel on a Stock Exchange's trading day, it will also be submitted, at the same time, in accordance with the reporting regulations of a foreign corporation, and, in the event that it has been submitted or it has been published on a non-trading day, it will be published not later than 9:30 am on the first day of trading following its submission or its publication outside of Israel.

Financial reports included in corporate reports of a corporation whose securities are listed for trade on the London Stock Exchange shall be compiled according to international accounting standards or according to the United States standards or according to accounting rules as defined under Securities Regulations (Preparation of Annual Financial Reports) 5753-1993.

Immediate reports of a foreign corporation must be submitted as follows:

> The corporation will submit reports on every matter on which it is obliged to carry out immediate reports in accordance with the foreign law and on every matter on which it publishes or reports immediately to the holders of its securities which are registered for trading on the stock exchange abroad, on dates determined under applicable foreign law or on the date it reported to the holders of its securities listed for trading on a foreign stock exchange, whichever is earlier. In the event such report has been published on a Stock Exchange non-trading day, it will be published not later than 9:30 am on the first day of trading thereon following its publication.

Other reports or notices of a foreign corporation must be submitted as follows:

> The foreign corporation will submit every report or notice or other document which it is obliged to submit or to publish in accordance with the foreign law or which it has submitted or it has published to those investing in its securities listed for trading on a stock exchange outside of Israel, and all other information which the corporation has received from its holders with regard to their holdings in the securities of the corporation and which has been published or which it is obligatory to publish in accordance with the foreign law for investors in its securities listed for trading on the stock exchange

> outside of Israel. Provisions regulating the filing of an annual report, a semiannual report or a quarterly report, as specified hereinabove, shall apply to such filing, *mutatis mutandis*

The Authority or an employee so authorised by it is entitled to instruct a foreign corporation, after it has been given the opportunity to make heard its claims, to submit an immediate report which amends a report or a notice which has been given as mentioned above, in the event that the Authority is of an opinion that the details in the report or in the notice which have been submitted by the foreign corporation do not comply with the provisions which are set out above. The Securities Authority may also contact the entity in charge of supervision or enforcement of the foreign law prior to contacting the foreign corporation as stated.

In the event that the Authority or the Chairman of the Authority believes that a particular corporation has been precluded from submitting a report or a notice in accordance with the applicable provisions of the Regulations at the date determined for such purpose, it may extend the period for its submission.

Transition from One Reporting Format to Another. A corporation whose securities are registered for trading on a Stock Exchange and are also registered for trading on a stock exchange outside of Israel and who reports in accordance with the ordinary reporting provisions of the Securities Law (i.e., other than in the framework of the double listing rules) may switch to reporting in accordance with the double listing rules, for so long as its securities are registered for trading on the stock exchange outside of Israel.

A corporation which reports in accordance with the double listing rules is entitled to switch to reporting in accordance with the ordinary provisions of reporting of the Securities Law. Transition from one reporting format to another, as mentioned above, requires the consent of a majority of the corporation's securities holders, with the exception of the controlling shareholders in the corporation, who participate in a vote at the class meetings of the securities' holders, convened by the corporation for this purpose.

Change of Reporting Format. Upon the corporation's transition from one reporting format to another, in accordance with the provisions mentioned above, the corporation will submit to the Authority and to the Stock Exchange and, in the event that it is incorporated in Israel, also to the Registrar of Companies, in accordance with the provisions of the reporting format to which it transferred, the following reports:

- An immediate report with regard to the above matter, within the time prescribed by the Authority;
- A periodic report for the period of the last reporting year preceding the date of the switch; and
- Interim reports following the periodic report of the last reporting year preceding the date of the switch.

Reporting Improvement Project

In 2010 the Authority launched the Reporting Improvement Project (the "Project"), intended to improve the reporting practices of reporting corporations in order to render to the public more relevant and useful information essential for making informed investment decisions.

The Project's key points were published in 2011 and 2012. Certain amendments to the Securities Regulations have begun to be enacted, implementing the Project's principles which are effective as specified hereinafter, and certain other amendments are expected to be drafted in the future, in order to incorporate all the Project's disclosure provisions in the corporations' periodic and interim reports.

Background

During the past few years, Authority staff members examined (i) companies' periodic and quarterly reports and the disclosures contained therein; (ii) the Barnea Committee's[112] recommendations regarding the development of industry-specific disclosure requirements; and (iii) general tendencies in disclosure requirements over the past few years, including the implementation of IFRS on financial reporting in Israel, as well as similar steps taken by other securities' regulators worldwide.

The Authority published its findings in connection with the forgoing, whereby the current disclosure provisions and their application are deficient. The main problem seems to be the excess and immaterial information which is included in the reports, as well as the lack of uniformity and clarity in the application of disclosure requirements, and insufficient business disclosure from management's point of view.

Accordingly, the Project determines, *inter alia*, the need for (i) modifications to the format of reports such that each chapter shall contain disclosure requirements of similar or identical purpose; (ii) industry specific disclosure requirements; (iii) clarification of the principles of materiality and reporting from the management's point of view; and (iv) establishing extensive disclosure provisions for various aspects of corporate governance.

New Report Format

In General

The new reports' format shall include four major chapters, as follows below.

112 The Committee on the Structure and Content of Annual Reports and Prospectuses, set up by the Authority in order to examine reporting and disclosures.

Management's Discussion and Analysis Report

This report will replace the existing board of directors' report. Its purpose is to review, from management's point of view, the state of the company's affairs and company's strategy. Main modifications therein, in comparison with the board of directors' report, include a requirement to review the state of company's business (with a breakdown among its fields of activities), detailing the impact of changes in the company's economic environment on its business activity and company's actions addressing such changes. The report shall be based on reviewed material information and the discussion and analysis brought before the company's management or conducted by it. The management's report shall also include a disclosure with regard to implementation of forward looking information received in the past. In addition to the signatures of the company's chairman of the board and chief executive officer, the chief operating decision maker, as determined in accordance with applicable accounting standards — as well as the chairman of the financial statements review committee — are also required to execute the report.

Description of Company's Business Report

(a) Industry-specific disclosure chapter — following the recommendations of the Barnea Committee to develop industry-specific disclosure requirements, and following changes in applicable accounting standards, the Authority published specific disclosure requirements for various industries, including investment property, entrepreneurial property, natural gas and oil activities, holding and investments entities as well as biomed companies. Disclosure directives for the investment property industry and the natural gas and oil industry are effective as of the periodic reports for 2011.

(b) Financing and liquidity chapter — creation of a new sub-chapter in the description of the company's business report, which integrates financing and liquidity risk aspects;

(c) Risk chapter — creating a new sub-chapter under the description of the company's business report, which focuses on risk management (including operational and market risks), for the purpose of creating a comprehensive overview of risks and an inclusive, unified approach thereto.

Financial Statements

Although the Project does not directly regulate financial statements, the disclosure requirements in the financial statements are also adjusted due to duplicative requirements of the new and existing regulations in other chapters of the periodic reports.

Corporate Governance Report

An Authority directive from 2012 instructs reporting corporations to incorporate into the periodic report a "designated corporate governance report", as an

integral part of annual financial statements, based – *inter alia* – on the disclosure requirements included in the Securities Regulations, the findings of the Goshen Committee,[113] as well as the provisions of the Companies Law.

The report includes a questionnaire, where an affirmative answer to any question therein constitutes a positive indication for the existence of adequate corporate governance, and vice versa. The questionnaire covers various aspects of corporate governance, including: (a) the board of directors' conduct; (b) the conduct of the audit committee and the financial statements review committee; (c) approval and control processes related to transactions with controlling shareholders; (d) the internal auditor; (e) the independent auditor.

Such standard questionnaire, requiring specific and focused disclosure as aforesaid, is expected to serve as an efficient platform for assessing the quality of corporate governance in companies and for the pricing of their securities. The Authority has recently announced that it shall publish the final form of the questionnaire in the near future and all reporting corporations are required to include it in their 2012 periodic reports.

Effective Provisions Related to Project

Real Estate

A new reporting format, implementing real estate specific disclosure requirements, came into effect, making more extensive use of tables and assisting in processing of periodic reports. Real estate companies shall provide details regarding comparative periods corresponding to those required in the financial statements: consequential data is required for three periods, but balance sheet data is presented for the reporting year and the end of the corresponding period.

The report also must include financial measures which are not based on IFRS, in order to increase comparability for the performance of the same company during different periods, as well as among different companies operating in the same industry. A new reporting format for the investment property industry establishes the use of accepted industry benchmarks, such as same property net operating income and funds from operations (FFO), which are significant and widely used for assessing the results and value of investment property companies. The new format also focuses on the companies' key assets and projects.

Expected Cash-Flow Statement

In November 2010, the Authority enacted disclosure directives pertaining to the preparation of expected cash flow statements by companies exhibiting certain warning signs according to Securities Regulation 10(b)(14) (Periodic and

113 As specified hereinafter in Corporate Governance section.

Immediate Reports) - 1970. The directive was published due to the need and significance of a clear criteria for the presentation of expected cash flow statements, including the assumptions underlying it and the board of directors' notes accompanying the statement.

Natural Gas and Oil Industry

A new reporting format regulates all aspects of reporting for oil and natural gas companies — periodic and interim reports, immediate reports and prospectuses. Reporting on resources and gas and oil reserves shall be made in accordance with the international SPE-PRMS model (Society of Petroleum Engineers — Petroleum Resources Management System). This model constitutes the basis for reporting on reserves and resources in the gas and oil industry in most developed countries, including the US and Canada. The directive also determines additional mechanisms for control over reporting, including the use of independent and qualified professionals, as well as management representation and disclosure mechanisms for the underlying assumptions used in preparation of reports.

Electronic Reporting

In General. Any and all reports and documents, which are required to be filed with the Authority by virtue of the Law and the regulations promulgated thereunder, are required to be filed by means of electronic reporting. The electronic reporting requirements are prescribed mainly within the framework of Chapter G1 of the Law, and within the framework of the Electronic Signature and Reporting Regulations.[114]

Modes of Reporting. A draft prospectus, a prospectus the publication of which has been permitted, a registration document and any report, opinion, or approval which are contained therein, and also any report, notice, or other document which must be submitted to the Authority or to the Stock Exchange in accordance with the Law, shall be submitted solely and exclusively by electronic reporting in accordance with the provisions of the Law and the Electronic Signature and Reporting Regulations.

A document which must be submitted both to the Securities Authority and to the Stock Exchange in accordance with the provisions of the Law and which was reported electronically to the Authority will be transferred by the Authority to the Stock Exchange, and the person that filed the electronic report with the Authority will be deemed to have complied with the requirement of filing with the Stock Exchange.

Security of Information. For the purpose of information security of documents which have been electronically reported to the Authority, the Authority will

114 Securities Regulations (Electronic Signature and Reporting), 5763-2003.

make use of a reliable software and hardware system which provides, to the Authority's satisfaction, reasonable protection against penetration, disruption, disturbance, or damage to computers or computer material and which provides a reasonable level of availability and reliability.

Electronic Signature. A person whose signature is required on a document which is submitted to the Authority will empower an authorised electronic signatory of the reporting entity[115] to sign on his behalf and to report electronically to the Authority, by attaching the approved electronic signature of the authorised electronic signatory.

If the signature of more than one person is required on that document, all the persons whose signatures are required shall authorise, as detailed above, only one authorised electronic signatory of the reporting entity; such authorisation must be signed by hand by everyone whose signature on the document is required under any law, stating his name and position in the reporting entity or any other connection that he has with the reporting entity, and he shall attach thereto, as an integral part thereof, the text of the document with regard to which the authorisation was given.

Notice to Securities Authority. In the event the wording of a document published via MAGNA[116] is not completely identical to wording submitted to the authorised electronic signatory of the reporting entity, the party who empowered the authorised electronic signatory shall submit to the Authority, no later than three trading days following the publication of the document via MAGNA, a written notice with this regard.

Appointment of Authorized Electronic Signatories. Within the framework of implementation of the electronic reporting, the reporting corporation is required, in accordance with Section 36 of the Securities Law (and including a foreign corporation which reports in accordance with the double listing rules), to appoint at least two senior officers to serve as electronic authorised signatories on its behalf, for the purpose of electronic reporting to the Authority.

The corporation is required to submit a request for approval of its electronic authorised signatories to the Authority.[117] Following such approval, the parties who are

115 "Reporting entity" — a reporting corporation, trustee of certificates of indebtedness, fund manager, fund trustee, fund liquidator, licensed corporation or underwriter.

116 *See supra* note 36.

117 An authorised electronic signatory of the corporation shall be an individual who serves as senior officer in the corporation and who has been appointed by the corporation to serve as proxy for the purpose of electronic reporting to the Securities Authority. A 'senior officer' for this purpose is a general manager, chief business manager, deputy to the general manager, vice-general manager, any person performing aforesaid functions in the company, director, manager who is directly subservient to the general manager, chairman of the board of directors, an substitute director, the comptroller, the internal auditor, an independent authorized signatory, any person holding any such position even if such person's title is different, a senior officer in a

designated to serve as the electronic authorised signatories of the corporation will, within 14 days from the date of this approval, approach the offices of the approver of the electronic signature, and acquire a means of electronic signature and documentation for the purpose of electronic reporting to the Authority.

Cancellation of Appointment of the Authorised Electronic Signatory. In the event that the reporting entity cancels the appointment of the authorised electronic signatory, it will give notice of such cancellation to the Authority and to the approver of the signature who issued the electronic approval to such authorised electronic signatory, not later than at the time at which the cancellation comes into force.

In the event that the authorised electronic signatory ceases to serve as a senior officer of the reporting entity, the reporting entity will give notice to the Authority, by means of electronic reporting, of the cancellation of his services as its electronic authorized signatory, and to the approver of the signature, of the cancellation of the electronic certificate.

Duties of Authorized Electronic Signatory. An authorised electronic signatory will not attach his approved electronic signature to a document and will not electronically report to the Authority, unless he has ensured one of the following:

- He is authorised in accordance with any law to sign the document as the sole signatory in the name of the reporting entity; and
- He has been authorised, as mentioned above, by every party whose signature on the document is required in accordance with any law, to sign the document on his behalf by means of his approved electronic signature, and to report electronically to the Authority, provided that the document to which he attaches his approved electronic signature and which he submits by electronic reporting to the Authority is absolutely identical by its content, structure, and form to the document which has been attached to the said authorisation, which have been delivered to him for the purpose of the electronic reporting to the Authority.

The authorised electronic signatory bears personal liability with regard to his duties specified above and he cannot release himself from such liability by authorising another person to use his means of signature for the purpose of electronic signature or reporting to the Authority.

Newspaper Publication. As of 2008, following enactment of the Securities Regulations (Publication of Newspaper Notices) 2008, the requirement for

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corporation controlled by the corporation, who has substantial influence over the corporation, any individual employed by the corporation in a different position who holds five percent or more of the nominal value of the issued share capital or of the voting power and including the secretary of the reporting entity, and its legal counsel.

details in a newspaper publication was changed to include materially less details, replaced by reference to the electronic report published by the corporation on the same matter, which enables to receive more information with respect to the subject event. The regulations require that the following be provided:

- Name of the reporting entity;
- Type of the reported event;
- Reference to an electronic report which enables to receive more information with respect to the subject event;
- Important dates which are essential to the investor;
- The dates of a shareholders meeting; or
- The dates of approving a purchase offer.

An Offeror That Is Not a Reporting Entity. An offeror in a purchase offer under the purchase offer regulations,[118] which is not a reporting corporation, or an offeror which is not an issuer obliged to publish a prospectus in accordance with the Law, and who is not a reporting corporation, will appoint an electronic authorised signatory as specified below:

- In the event that the offeror is a corporation, it will appoint one or more senior officer to serve as an authorised electronic signatory on its behalf for the purpose of electronic reporting to the Authority with regard to the purchase offer; and
- In the event that the party who is offering is an individual, he himself is entitled to serve as an electronic authorized signatory or to appoint an electronic authorized signatory, one or more, on his behalf for the purpose of electronic reporting to the Authority for the matter of the purchase offer.

Corporation Seeking to Offer or to Register Its Securities for First Time. A corporation which seeks to offer its securities for the first time pursuant to a prospectus, or a corporation which seeks to register its securities for the first time for trading on the Stock Exchange pursuant to a prospectus or a registration document, shall appoint at least two senior officers to serve as authorised electronic signatories on its behalf for the purpose of the submission of documents by electronic reporting to the Authority.

An application for registration of electronic authorized signatories on MAGNA, shall be signed on behalf of the corporation by hand by the chairman of its board of directors and its general manager or a director empowered by board of directors to sign the application instead of one of them, stating the names of the signatories and their positions in the

118 Securities Regulations (Purchase Offer), 5760-2000.

corporation; the application will be submitted to the Securities Authority at its office in Jerusalem by hand delivery or by mail.

In the event that securities of the corporation are offered to the public in accordance with a prospectus or they are registered for trading on the Stock Exchange in accordance with a listing document, the corporation will submit to the Authority within one trading day from the day of receipt of the permit for the publication of the prospectus or from the day of the publication of the listing document, as the case may be, by means of electronic reporting, forms of initial data as follows:

- Its documents of incorporation;
- Details of the principal shareholders and their holdings;
- Details of the senior officers;
- Details of the registered shareholders;
- Details of the registered capital, the issued capital, and its additional securities;
- Details of the dormant shares in its capital;
- Details of its auditor; and
- In the event bonds were issued, the deed of trust.

Forms of initial data as mentioned will be submitted in their entirety all at one time. The provisions which are mentioned above, *mutatis mutandis*, will apply to a corporation which is seeking to offer its securities for the first time or to register its securities for the first time, to an authorised electronic signatory on its behalf, and to every document in their possession which is reported electronically.

Non Electronic reporting. In the event that the Chairman of the Authority believe that exceptional circumstances exist in connection with the activity of MAGNA, he may instruct that, throughout such period as he deems appropriate and which does not exceed the minimum period which is required under the circumstances, the reporting to the Authority and to the stock exchange shall be effected other than by means of electronic reporting, and in such manner as he instructs.

Such provision will be published on the Web site of the Authority, in two daily newspapers, and by means of additional media communication as is deemed to be appropriate. The documents specified below will be submitted to the Authority at its office in Jerusalem only by means of hardcopy reporting:

- Application for exemption from a specific disclosure in the prospectus in accordance with Section 19(a) of the Law and documents in connection therewith; and
- Application for exemption from a specific disclosure in the immediate report in accordance with Section 36c(a) of the Law and documents in connection therewith.

- Within the framework of the Electronic Reporting Regulations, are also included, *inter alia*, arrangements in relation to the technical aspects of the electronic reporting.

Voting Instruments and Opinion Statements

In General. Within the framework of recent global technological advancements, the issue of remote voting under Israeli law was addressed upon legislation of the Voting Instruments Regulations in 2005, enacted under Section 89 of the Companies Law.

This issue revolutionised the manner in which shareholders vote at general meetings: under the Voting Instruments Regulations, shareholders can vote by means of a voting instrument or via the Internet (if such option is allowed by the company), without the need to physically attend the general meeting, nor nominate a proxy. Voting in these ways allows shareholders to use their voting power more effectively, and promote a democratic corporate regime. The Voting Instruments Regulations apply to general meetings of shareholders, the agenda of which includes one or more of the following issues:

- Appointment and removal of directors;
- Approval of acts or transactions requiring the approval of the general meeting pursuant to the provisions of Sections 255 and 268–275 of the Companies Law;
- Approval of a merger;
- Authorization of the chairman of the board of directors or his relative to hold the position of general manager or to exercise his powers, and authorization of the general manager or his relative to hold the position of the chairman of the board of directors or to exercise his powers, for periods not exceeding 3 years each, provided that one of the following occurs: the majority of votes at the general meeting includes, at least two-thirds of the votes of the shareholders who are not controlling shareholders of the company nor holders of a personal interest in the approval of the resolution participating in the vote, the abstaining votes not being taken into account; or the objecting votes do not exceed two per cent of the voting rights in the company;[119]
- Any other matter in respect of which the articles of association of the corporation provide that resolutions of the general meeting may also be passed by means of a voting instrument; and
- Convening of a meeting in accordance with the provisions of Section 350 of the Companies Law.

Notwithstanding the foregoing, the provisions of the Voting Instruments Regulations shall not apply in the event the company's controlling shareholder

119 Companies Law, s 87, 121(c).

holds on the date of the shareholders' meeting, to the best of company's knowledge, shares of the company amounting to the rate necessary to adopt the resolution on the agenda, assuming all other shareholders shall attend the meeting and vote against the resolution.

According to the Voting Instruments Regulations, an unregistered shareholder, who wishes to vote in a general meeting without attending it and without nominating a proxy, may vote with a voting instrument.

In addition, an unregistered shareholder also may vote through the Internet, provided that the company has so informed its shareholders (and facilitated the required means).

In addition, a registered shareholder who wishes to vote in writing, shall note in the form the manner in which he chooses to vote, and deliver said form to the company or shall mail it to the company by registered mail, together with a photocopy of his identity card or his passport or, in the case of a corporation, its incorporation certificate, so that the voting instrument shall reach the company's registered office at least 72 hours before the date of the general meeting.

A shareholder may approach the company's registered office, up to 24 hours before the date of the general meeting and, after proving his identity to the satisfaction of the company's secretary, may withdraw his voting instrument and ownership authorisation, or cancel his vote; if so, the shareholder may vote only during the general meeting itself. The company may attach a notice of opinion of its board of directors to the form of the voting instrument.

A notice of opinion also may be received from a shareholder within the period prescribed in the Voting Instruments Regulations, in which case the company must deliver such notice of opinion to the Securities Authority and the stock exchange. The company may furnish the Authority with a notice of opinion which includes the company's board of directors' response.[120]

Trading Laws

Transactions between Public Company and Its Controlling Shareholder

In General. The issue of conflicts of interests between the controlling shareholder and the public company, within the framework of transactions of the public company with the controlling shareholder or with third parties in which the controlling shareholder has a personal interest, has been legislatively addressed within the framework of Securities Regulations and the Companies Law,[121] by means of extensive legislative arrangements and today this issue is regulated at the pre-event and pre-approval disclosure level, at the approval level, and at the post approval and post event reporting levels. In the chapter of

120 Companies Regulations (Voting Instrument and Opinion Statements), 5766-2005.
121 Companies Law, 5759-1999.

transactions with interested parties in the Companies Law, the following requirements have been, *inter alia*, determined:[122]

- The obligation of disclosure of a personal interest which is imposed on a controlling shareholder as specified below;
- The obligatory mechanism of special approvals by the board of directors, by the audit committee, and sometimes also by the general meeting, with regard to certain transactions, as specified below; and
- Sanctions and remedies against the controlling shareholder and provisions regulating the validity of the transaction with him or with third parties in which he has a personal interest, in the event that such transaction has not been approved in accordance with the provisions of "the transactions with interested parties'" chapter.

The approval requirements with regard to transactions between a public company and its controlling shareholder are even more extensive, as detailed hereunder.

Disclosure of Personal Interest in a Transaction of Public Company. A controlling shareholder[123] in a public company or in a Debenture Company who is aware

122 The chapter also regulates the issue of the personal interests of directors and officers in the company.

123 The definition of a controlling shareholder changes in accordance with the legislative context. For the purposes of this Section, the appropriate definition of a controlling shareholder is the one contained in the Companies Law and it means a controlling shareholder as defined in the Securities Law, including a party who holds 25 per cent or more of the voting rights in the general meeting of the company in the event that there is no other person who holds more than 50 per cent of the voting rights in the company; for this purpose, two or more parties that hold a voting right in the company and each one of them has a personal interest in the approval of a transaction submitted for the approval of the company, will be deemed a sole holder. In accordance with the Law 'Control' is defined as follows: (i) the ability to direct the activity of the corporation, excluding the ability which arises only from the fulfillment of the function of director or some other position in the corporation, and (ii) the holdings of a person in a corporation in the event that he holds one-half or more of a certain category of means of control in the corporation. Each one of the following is deemed to be 'means of control' in a corporation: (i) the right to vote in a general meeting of the company or in a similar body of some other corporation, and (ii) the right to appoint directors or the general manager of the corporation. It should be noted that for the purpose of the definition of 'control' in accordance with the Law, it has been determined that for the purpose of securities or voting power 'holding' is either solely or together with others, whether directly or indirectly, by means of a trustee, a trust company, a registrations company, or in any other manner. Furthermore, it has been determined that in context of a holding or of purchase by a company, the holding is also deemed to be by its subsidiary or affiliate and, in the context of a holding or of purchase by an individual, the individual and the members of his family who reside with him or persons that are

that he/it has a personal interest[124] in a current transaction or in a transaction which is proposed to the company, shall disclose to the company, without delay, and not later than at the meeting of the board of directors at which the transaction has been first discussed, the nature of his personal interest, including every material fact or document related thereto. This provision will not apply if

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provided by him with the livelihood income, shall be deemed one person for the purpose of calculation of the holdings. In addition, for the purpose of the examination of the control, the holding of securities or their purchase under collaboration between two or more parties in accordance with agreement, whether written or verbal shall be deemed to be the joint holding of securities. Furthermore, without prejudice to the generality of the foregoing, the following will be deemed to be the holders of securities or the joint acquirers of such securities: a corporation which holds or which acquires securities together with the holder of an interest in such corporation, or with one of its affiliated companies, and a person who is engaged in the holding of securities or trading in them on behalf of another party, together with his client or with a member of his family who does not reside with him, and in case one does not provide the livelihood of the other, for whom he holds and administers the securities in accordance with a power of attorney which grants discretion in use of the voting right.

124 'Personal interest' is defined in the Companies Law as a personal interest of a person in an activity or in a transaction of the company, including a personal interest of his relative and of other corporation in which either he or his relative are principal shareholders, excluding personal interest which derives from the fact of the holding of shares in the company, and including personal interest of a person voting under proxy granted to him by a third party who does not have a personal interest therein or voting by a person granted a proxy by a third party who has a personal interest therein, regardless of whether such voting is made upon the proxy's discretion.

In several cases which have recently been brought before the Israeli courts, certain public companies claimed that "personal interest" also includes a "negative personal interest"; that is to say that a denial by a minority shareholder, arising out of his personal interests, to approve certain transactions, alleged to be in the company's best interest, should be classified as a personal interest. Accordingly, if a certain shareholder opposes certain transactions between the company and its controlling shareholder, the company has full discretion to classify such shareholder as having a negative personal interest in such approval, and consequently, disqualify his votes (i.e. disqualify as a non-affiliated vote and count only as an affiliated vote). The Authority is of the opinion that the vote of a shareholder opposing the transaction should be disqualified, only in case he is misusing his voting power and votes on the basis of unlawful considerations, in violation of the obligations of good faith and fairness imposed on him as a shareholder; the company is not entitled to disqualify the vote of an opposing shareholder, even if the company believes that such shareholder voted on the basis of unlawful considerations; the determination whether a certain shareholder has a negative personal interest, should be made by a competent court only, which may, *inter alia*, invalidate the vote of an opposing minority shareholder; the company or its controlling shareholder are to apply to the court for the said remedy of disqualification.

the personal interest arises only from the existence of a personal interest of a relative[125] in a transaction which is not exceptional (as is defined below).

An interested party (a principal shareholder), or whomever will become a controlling shareholder as a result of a private placement, who is aware that he has a personal interest in the substantial private placement, shall disclose the essence of his personal interest to the public company without delay, including any material fact or document related thereto.

The controlling shareholder in a public company, who has not disclosed his personal interest, as mentioned, will be deemed to have breached his duty of fairness towards the company. Breach of the duty of fairness is deemed to constitute a breach of the fiduciary duty of an officer in the company, *mutatis mutandis*, and, accordingly, the laws which apply to the breach of contract will apply, *mutatis mutandis*, to the breach of the duty of fairness.

Transactions That Require Special Approval. In addition to the obligation of disclosure, certain transactions of the controlling shareholder with the company require specific approvals (hereinafter: "the transactions which require special approvals") as specified below:

- An exceptional transaction[126] of a public company[127] or a Debenture Company with its controlling shareholder;
- An exceptional transaction of a public company or a Debenture Company with any other person in which the controlling shareholder has a personal interest, including a private offer in which the controlling shareholder has a personal interest; and
- Engagement of a public company or a Debenture Company with its controlling shareholder, or his relative, directly or indirectly, including through a company controlled by him, concerning services received by the company and, in the event that he is also an officer in such company, with regard to the terms of his holding of office and his employment and, in the event that he is an employee of the company and not an officer in such company, with regard to his employment in the company.

The transactions which are mentioned above require approval as specified below, in the following very specific order, whereby approval of the board of directors and approval of the general meeting are subject to obtaining the

125 Spouse, brother or sister, parent, grandparents, descendant and also spouse's descendant, brother, sister or parent or the spouse of any one of such persons.

126 'Transaction' — a contact or engagement and also a unilateral decision of the company with regard to the granting of a right or some other benefit — the Companies Law, s 1.

127 A company whose shares are registered for trading, or which have been offered to the public in accordance with a prospectus as defined in the Securities Law, and which are held by the public.

approval which precedes each of them, and provided that these transactions do not adversely affect the benefit of the company:[128]

- Approval of the audit committee;[129]
- Approval of the board of directors; and
- Approval of the general meeting of shareholders, by which, either (i) the resolution is approved by at least a majority of the votes of the shareholders who are not holders of a personal interest in the approval of the transaction participating in the vote provided that the abstaining votes will not be taken into account; or (ii) the total of the votes of the objecting shareholders among those that are not holders of a personal interest in the approval of the transaction does not exceed two per cent of the voting rights in the company. The Minister of Justice is entitled to determine rates which are different than the rate which is mentioned. In case that the term of a transaction which requires special approval is above three years, the transaction will require such approval every three years.

Notwithstanding the above, an exceptional transaction of a public company with its controlling shareholder and an exceptional transaction of a public company with any other person in which the controlling shareholder has a personal interest, including a private offer in which the controlling shareholder has a personal interest, may be approved for a period longer than three years provided that the audit committee has confirmed that the term of such transaction is reasonable in the specific circumstances. In addition, approval of the audit committee and the board of directors are required in the event of certain extraordinary and other transactions between a Debenture Company and its controlling shareholder. Additionally, in each of the forgoing both the audit committee and the board of directors are required to determine whether the transaction includes a distribution, and if so, such transaction shall be approved,

128 Regarding such transactions that require special approvals, the approval of the audit committee and the board of directors, obtained in this order only, are sufficient in Debenture Companies.

129 The audit committee in a public company will not be entitled to approve interested parties' transactions, unless such committee includes at least three members, all incumbent external directors are members therein and the majority of its members are independent directors. The following officers are precluded from serving as members of the audit committee: (i) the company's controlling shareholder or its relative, (ii) the chairman of the board of directors, (iii) any director who is employed by the company or by its controlling shareholder or by a corporation controlled by such controlling shareholder, (iv) a director who provides services on a regular basis to the company, its controlling shareholder or a corporation controlled by such controlling shareholder, and (v) a director whose source of livelihood depends on the controlling shareholder. The chairmen of the audit committee shall be an external director which holds this position less than nine (9) years.

only after both of these bodies have approved that the provisions of any relevant laws regarding distributions have been fulfilled. With respect to a Debenture Company, if the audit committee and the board of directors have determined that the transaction does not include a distribution, both of them shall examine whether there is a reasonable concern that the transaction would prevent the company from meeting its existing and foreseeable obligations as they mature; the transaction cannot be approved in the event that either the audit committee or board of directors have stated that such reasonable concern exists.

A shareholder who participates in a vote at the general meeting as mentioned is obliged to give notice to the company prior to the vote at the meeting or, in the event that the vote is by means of a voting instrument, through the voting instrument, whether he has or does not have a personal interest in the approval of the transaction. In the event that the shareholder has not given such notice, his vote will not be taken into account.

Sanctions in Respect of Absence of Approval

Transaction Lacking in Validity. A transaction of a public company and a Debenture Company with its controlling shareholder requiring special approvals will not be valid towards the company and towards the controlling shareholder, in the event that:

- The transaction has not been approved in accordance with the provisions of the transactions with the interested parties chapter;
- A material defect has occurred in the approval process; or
- The transaction was performed in material deviation from the approval.

Furthermore, such transaction will not be valid towards a third party in the event that such third party was aware of the personal interest of the controlling shareholder in the approval of the transaction and was aware or should have been aware of the absence of approval of the transaction as required in accordance with the provisions of the transactions with interested parties chapter.

Revocation of Transaction. A company is entitled to revoke a transaction with any other person, which requires an approval as mentioned above, and it is also entitled to claim compensation from him in respect of the damage caused to it, also without revocation of the transaction, in the event that such person was aware of the personal interest of the controlling shareholder in the public company or in the Debenture Company in the approval of the transaction, and was aware or should have been aware of the absence of approval of the transaction as required in accordance with the provisions of the transactions with interested parties chapter.

Conflicts of Interests between Public Company and Its Controlling Shareholder. Within the framework of the regulations of the relief in transactions with interested parties,[130] a string of relief options, including relief in relation to exceptional transactions between a company and its controlling shareholder, have been added.

In accordance with these relief options, an exceptional transaction of a public company will not require the approval of the general meeting as mentioned above in the event that one of the following is fulfilled, and provided that the audit committee and the board of directors of the party, which is a public company, have approved such fulfilment:

- The transaction does not affect the company in any form other than benefiting the company, or the change has no effect other than to benefit the company;
- It protracts an existing transaction, provided that such transaction existing between such parties has been approved as mentioned above,[131] and provided that no material change has occurred in the terms of the additional transaction and in the remainder of the circumstances which are required for the matter *vis-à-vis* the existing transaction;
- It is a transaction of the public company with its controlling shareholder or with another person in whom the controlling shareholder has a personal interest, provided that it complies with the terms determined within the framework transaction which has been approved by the audit committee, the board of directors, and the general meeting as mentioned above,[132] permitting the company to enter, during its ordinary course of business, into transactions of the category determined in it, and determining in advance the period and the remainder of the terms for transactions as mentioned;
- It is a transaction of the public company with its controlling shareholder or with any other person, in whom the controlling shareholder has a personal interest, for the purpose of their transaction with any other party or for the purpose of the submission of a joint offer for engagement with any other party, and the terms of such transaction with regard to the public company are not materially different from the terms with regard to the controlling shareholder or a corporation under its control, taking into account their proportional share in the transaction;

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130 Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000.

131 Or in the event that it has been approved in the past in accordance with the Securities Regulations (Restrictions in the Matter of Conflict of Interests between a Listed company and the Controlling Shareholder), 5754-1994.

132 Or in the event that it has been approved in accordance with the Securities Regulations (Restrictions with Regard to Conflict of Interests between a Listed Company and the Controlling Shareholder), 5754-1994, or in accordance with a framework resolution which the audit committee, the board of directors and the general meeting of the company passed before May 23 1998.

- It is a transaction between companies which are under the control of the same controlling shareholder, inter se, or between a public company and its controlling shareholder or between a public company and any other person in whom the controlling shareholder has a personal interest, and the engagement is under market conditions and during the ordinary course of business and it does not adversely affect company's best interests; and
- When the transaction has been approved by the audit committee and by the board of directors, the rate of voting rights held by the company's shareholders who have no personal interest in the transaction, did not exceed one percent of company's total voting rights.

Furthermore, the entry into an engagement of a public company with its controlling shareholder who is also an officer in such company, or with a relative of the controlling shareholder who is also an officer in such company, with regard to the terms of his office and his employment, and in the event that he is an employee of the company and he does not hold an office in such company, with regard to the terms of his employment in the company as mentioned above, will not require the approval of the general meeting as mentioned above, in the event that one of the following are fulfilled, and provided that the audit committee and the board of directors have approved that:

- The transaction does affect the company other than benefiting it;
- The cost to the company does not exceed NIS 20,000; a relief in accordance with this section may be given to the controlling shareholder in the company only once every two years, either by a onetime payment or by installments, and provided that the rest of the terms of the office and the employment of the controlling shareholder were not approved according to the relief with regard to the monthly remuneration, as stated below, and the cumulative cost to the company during the course of two years does not exceed that which is stated;[133]
- The remuneration which is paid to the controlling shareholder or his relative, in their capacity as director of the corporation, does not exceed the lowest remuneration paid to another director in the company, and does not exceed the maximal annual remuneration and the maximal participation remuneration which is paid in accordance with the Regulations of remuneration of external directors;[134]

133 The amount determined under this relief changes annually, on 1st of January every year, in accordance with the rate of the change of the new index (the index which was last published prior to the day of the change) *vis-à-vis* the basic index (May 2000).

134 The Companies Regulations (Rules with Regard to Remuneration and Expenses for External Director), 5760-2000. The amounts of the annual remuneration and the partition remuneration contained in the charts in the second and the third supplement

- The monthly remuneration paid to the controlling shareholder or his relative does not exceed the average monthly remuneration in Israel, and it is reasonable considering the scope of employment, the nature of the office, and the skills of the controlling shareholder or his relative, to perform his office; provided no more than two persons can serve or be employed by the company at the same time under this provision; and
- The engagement is with regard to the terms of the insurance of the controlling shareholder or his relative, who is an office holder in the company, provided that the terms of the engagement are less favorable than or equal to the terms of the engagement of the rest of the office holders in the company, and are at market conditions and shall not adversely affect the company's revenues, assets or obligations.

Notwithstanding the aforesaid, the aforementioned possibilities of relief will not apply to a public company in the event that one or more of its shareholders, holding at least one per cent of the issued share capital or of the voting rights in the company, has given notice of his objection to the granting of the relief as mentioned, and provided that the objection has been submitted to the company in writing not later than 14 days from the day (i) on which the public company has submitted a report in accordance with the Law on the adoption of the resolution or from the day on which it has submitted an amending report to said report, or (ii) in case of a company which is not a reporting corporation as defined in the Law, from the day on which the company has reported to its shareholders of the resolution with regard to said transaction. In the event such objection has been submitted as mentioned, then the transaction will be subject to the approval of the general meeting.

Transactions between Public Company and Officer in Such Company. This matter is extensively referred in the chapter of transactions with interested parties, and part of the arrangements which apply to the controlling shareholder also applies, *mutatis mutandis*, to an officer in the company.

Disclosure of a Personal Interest of an Officer in a Transaction of a Public Company. An officer in a public company who is aware that he has a personal interest, as defined above, in a current transaction or in a transaction which is proposed by or to the company, will disclose to the company, without delay, and not later than at the meeting of the board of directors at which the transaction is first discussed, the nature of his personal interest, including every material fact or document.

This provision does not apply if the personal interest has arisen only from the existence of a personal interest of a relative, as defined above, in a transaction which is not exceptional.

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to the said regulations are determined in accordance with the grading of the company in accordance with its equity capital.

An officer in a public company who has not disclosed his personal interest as mentioned will be deemed to have breached his fiduciary duty towards the company, and the laws which apply to breach of contract will apply, *mutatis mutandis*.

Transactions of Officer That Require Special Approvals. In addition to the obligation of disclosure as is mentioned, certain transactions of an officer with the company require special approvals as specified below:

- A transaction of the company with its officer; and
- A transaction of the company with any person, in which an officer of the company has a personal interest.

In the event that these transactions are not exceptional transactions, they require the approval of the board of directors. In the event that these transactions do constitute exceptional transactions, they require the approval of the audit committee of the company,[135] followed by the approval of the board of directors. Nevertheless, a person that is an officer both in a parent company and in its wholly owned and controlled subsidiary shall not be deemed to be the holder of a personal interest in a transaction which is carried out between the parent company and the subsidiary, only due to his serving as an officer in both of them or due to the fact that he holds shares or securities convertible into shares in the parent company. Furthermore, an officer in several subsidiaries wholly owned and controlled by the same person shall not be deemed to be the holder of a personal interest in a transaction which is carried out between such subsidiaries, only due to his service as an officer in the contracting companies. The following engagements of a company with its officer who is not a director, with regard to his employment and terms of service, including, *inter alia*, granting of an exemption, insurance, undertaking to indemnify or indemnification under an indemnity agreement, require special approvals, as follows:

- Officers' terms of employment and service;
- The grant of an exemption from breach of duty of care towards the company;
- The grant of liability insurance to an officer due to the liability imposed (i) in respect of a breach of the duty of care of an officer towards the company or towards any other person, (ii) in respect of a breach of the fiduciary duty towards the company and provided that the officer acted in good faith and had a basis to presume that the activity would not adversely affect the welfare of the company, and (iii) in respect of a financial liability imposed on the officer for the benefit of any other person; and

135 Under the Companies Law a public company is required to appoint an audit committee. If a private company, which is not a Debentures Company, does not have an audit committee, the transaction requires the approval only of the board of directors, provided that the office holder is not a director and, in case the office holder is a director, the approval of the general meeting is required as well.

- The grant of an undertaking for indemnity or indemnity in accordance with an indemnity agreement (i) in respect of a financial liability which has been imposed on the officer for the benefit of any other person in accordance with a judgement, including a judgement which has been given in a compromise settlement or in an arbitration judgement which has been approved by the court, (ii) in respect of reasonable litigation expenses, including lawyers' professional fees, which have been incurred by the officer or for which he has been found liable by the court, (iii) in respect of reasonable litigation expenses, including legal fees, expended by an office holder due to an investigation or a proceeding, conducted against him by a competent authority, and which was terminated without criminal charges filed against him (as defined in the Companies Law) and without a financial liability imposed on him as an alternative to criminal proceedings (as defined in the Companies Law), or which terminated without criminal charges filed against him but with a financial liability imposed on him as an alternative to criminal proceedings in an offence which does not require willful intent or in connection with financial sanction, as defined in the Law, (iv) in proceedings which were submitted against him by the company or in its name or by any other person, or in a criminal prosecution in which he had been acquitted, or in criminal proceedings in which he was convicted of an offence which does not require proof of criminal intent.

In a public company, such events require the approval of the audit committee, followed by the approval of the board of directors regarding the engagement of a company with its officer who is not a director with regard to the terms of his holding office, including the granting of exemption, insurance, undertaking for indemnity, or indemnity in accordance with an indemnity agreement as mentioned above. Notwithstanding the foregoing, this type of events may be approved by a special directors' committee for remuneration issues instead of the approval of the audit committee, provided that any and all provisions applicable to the audit committee under the Companies Law, shall apply to such special committee. Furthermore, in case the said transaction is actually a change of an existing transaction, such change requires only the approval of the audit committee stating that the said change in the transaction terms, is immaterial compared to the existing transaction.

An engagement of a company with a director with regard to his employment and service terms, including, *inter alia*, grant of exemption, insurance, undertaking to indemnify or indemnification under an indemnity agreement, and also with regard to the terms of his employment in other positions, require the approval of the audit committee, followed by the approval of the board of directors in private companies, and in a public company as well as in Debenture Companies, followed by the approval of the board of directors and then the approval of the general meeting, with the exception of certain circumstances further detailed in

The Regulations of Relief in Transactions with Interested Parties.[136] In the event that several issues of personal interest, requiring special approvals as detailed hereinabove, exist in a transaction (both with regard to the controlling shareholder and with regard to an officer), the events require accumulative approvals in accordance with the provisions which apply to each one of such issues of personal interest.

Abstention by Parties Having Personal Interest. A person who has a personal interest in the approval of a transaction (with the exception of a transaction of a company with its officer which is not exceptional or a transaction of a company with any other person, in which an officer in the company has a personal interest and which is not exceptional) which is submitted for the approval of the audit committee or of the board of directors will not be present at the discussion and will not participate in the vote in the audit committee and in the board of directors. However an officer having a personal interest is allowed to be present for the purpose of presenting the transaction, only if the chairman of the audit committee or the chairman of the board of directors, as the case may be, has determined that he is essential for such presentation.

Notwithstanding the foregoing, a director is entitled to be present at a discussion in the audit committee and to participate in the vote, in the event that the majority of the members of the audit committee have a personal interest in the approval of the transaction. A director is also entitled to be present at a discussion in the board of directors and to participate in the vote, in the event that a majority of the directors of the company have a personal interest in the approval of the transaction. In the event the majority of the directors in the board of directors of the company have personal interest in the transaction, such transaction also requires the approval of the general meeting.

Sanctions in Respect of Non-Approval of Transactions with an Officer. The sanctions which are mentioned above in relation to non-approval or improper approval of exceptional transactions with a controlling shareholder (a transaction which is invalid, and cancellation of transactions) will apply, *mutatis mutandis*, also to transactions of the company with its officers, which has not been approved as specified above.

Relief in Engaging Public Company with a Director with Regard to His Terms of Office. The Regulations of Relief in Transactions with Interested Parties[137] determine that the engagement of a public company with a director in respect of the terms of his office, including the grant of exemption, insurance, undertaking to indemnify, or indemnity, in accordance with an indemnity agreement as mentioned above, and also engagement of the company with a

136 Companies Regulations (Easements in Transactions with Principal Shareholders), 5760-2000, s 1A.

137 Companies Regulations (Easements in Transactions with Principal Shareholders), 5760-2000.

director in respect of the terms of his employment in other positions, will not require the approval of the general meeting as mentioned, in the event that one of the following is fulfilled, provided that the audit committee and the board of directors have approved such fulfillment: (i) the transaction does not affect the company other than benefiting the company; or (ii) the remuneration which is paid to the director does not exceed the maximal annual remuneration and the maximal participation remuneration paid in accordance with the Regulations of Remuneration of External Directors.[138]

Notwithstanding the above, the last relief with regard to the terms of the holding of office and the employment of a director in a company will not apply to a public company in the event that one or more of its shareholders, who holds at least one per cent of the issued share capital or of the voting rights in the company, has given notice of his objection to the grant of the relief as mentioned, provided that the objection has been submitted to the company in writing not later than 14 days (i) from the day on which the public company has submitted a report in accordance with the Law on the adoption of the resolution or from the day on which it has submitted an amending report to said report, or (ii) in case of a company, which is not a reporting corporation as defined by the Law, from the day on which the company has reported to its shareholders of the resolution with regard to said transaction. In the event that objection has been submitted as mentioned, then the transaction is subject to the approval of the general meeting of such company's shareholders.

Report on Transaction between Reporting Corporation and Its Controlling Shareholder

The Regulations of Transactions Between a Company and its Controlling Shareholder[139] address the requirements, actions, and reporting aspects applicable to a transaction between a reporting corporation and its controlling shareholder, including in respect of grant of a loan to the controlling shareholder[140] or from the controlling shareholder to a company or amending the terms thereof, payment of remuneration to the controlling shareholder, participation in the expenses of the controlling shareholder, and payment to the controlling shareholder in respect of his services, including management services. In addition, various details should be reported with regard to the following: an outline, clarifications of the annual financial statements, and clarifications for the interim period, as specified above

138 Companies Regulations (Rules with Regard to Remuneration and Expenses for External Director) 5760-2000. The amounts of the annual remuneration and the participation remuneration included in the second and the third supplement to the said regulations are determined in accordance with the rating of the company in accordance with its equity capital.

139 Securities Regulations (Transaction between a Company and the Controlling Shareholder), 5761-2001.

140 'Controlling shareholder' shall mean also any other person with whom the controlling shareholder has a personal interest in a transaction.

within the framework of the paragraphs reviewing the various aspects related to private offering.

Corporate Governance

In General

In December 2006, the Securities Authority announced the approval of the final version of the Goshen Report addressing the proper structure and content of an Israeli corporate governance code which recommends the assimilation of a corporate governance regime, intended to constitute an additional layer of requirements above and beyond those applicable under the existing laws. The application and adoption of such regime by companies is not mandatory, but if not adopted by a public company, would require it to disclose its resolution not to adopt such regime.

In September 2008, the 8th Amendment to the Companies Law came into effect and became binding. The 8th Amendment introduced various arrangements designed to strengthen the independence of the board of directors of public companies, primarily relating to the creation of the independent directors concept as a part of the board of directors and the visibility of the company director qualifications.

This trend continued in later legislative amendments, and major parts of recommendations included in the Goshen Report and related to corporate governance regime was implemented in the 16th amendment to the Companies Law, which came into effect in September 2011 (the "Amendment"). The Amendment augments the following issues:

Independence of Board of Directors — Appointment of External Directors and Their Relationship with Company

The Amendment reinforces the power of non-controlling shareholders in public company as well as of shareholders that do not have a personal interest in the approval of certain corporate resolutions, by raising the percentage of votes of such holders required for approval thereof. Pursuant to the Amendment, an external director will be appointed by the general meeting, if his appointment is approved by (i) a majority of the shares voted at the meeting that are held by non-controlling shareholders or their representatives and shareholders who do not have a personal interest in such election (the "Non Interested Shareholders"),[141] or (ii) the total number of shares held by the Non Interested Shareholders that voted against the election of the external director does not

141 Companies Law, s 239 (b)(1) – thus increasing the previously required vote of only one third of the Non Interested Shareholders.

exceed 2% of the aggregate voting rights in the company, even if the majority of shares held by the Non Interested Shareholders was not obtained.[142]

A person may not be appointed as an external director (i) if he is a relative of the controlling shareholder; (ii) if on the date of his appointment or during the two years that preceded the date thereof he, his relative, partner, employer or a corporate entity controlled by him had an affiliation with the company, company's controlling shareholder, controlling shareholder's relative, or a corporate entity, controlled by the company or its controlling shareholder at the date of, or during two years prior to, the appointment; and (iii) in case the company does not have a controlling shareholder or a holder of a controlling block of shares (25 per cent or more of the voting power), if he has, as of the date of such person's appointment, any affiliation with the then chairman of the board of directors, the chief executive officer, a principal shareholder (5 per cent or more of the issued share capital or voting power), or the most senior financial officer in the company.

The definition of the term "affiliation" has been extended in a manner that it includes business or professional relationship with the company or its controlling shareholders, even if such relationship is not maintained on a regular basis (but excluding insignificant relationship).

An external director may be elected for three consecutive terms of three years. However, while the initial term of director's office requires a majority vote as specified above and, effectively, the vote of the controlling shareholder, the extension of the external director's office for the two subsequent terms may be approved even if the controlling shareholder opposes the appointment, under either of the following: (i) (a) the external director is nominated by one or more shareholders holding at least one per cent of the company's voting power; (b) such extension is approved at the general meeting by a majority of shares present and voting, which are held by Non Interested Shareholders, provided that such shares represent at least 2 per cent of the total voting power in the company; or (ii) (y) the external director is nominated by the board of directors; (z) such extension is approved by the same majority as required for the election for the initial term of service, as specified hereinabove.[143] Companies are entitled to determine in their articles of association that their external directors will be appointed for two terms of office only (i.e., that the aggregate term of office may not exceed six years). To the extent such provision is adopted by a company, it will apply only to external directors who are appointed following such adoption.[144]

The Amendment broadens the prohibition on a company to employ an external director or engage his services (as well as his relatives). The company, its

142 Companies Law, s 239 (b)(2).
143 Companies Law, s 245 (a1).
144 Companies Law, s 245 (a3).

controlling shareholder or a corporation under controlling shareholder's control shall not grant any benefit, directly or indirectly, to a person who served as an external director of the company (and his spouse or children), including by way of his or their appointment as officer of the company, of a corporation under controlling shareholder's control, his employment or obtaining of his services, including the services of a corporation under his control, during a period of two years following the termination of his office.[145] The aforesaid limitation applies to an external director's relative, who is not a spouse or child, for a period of one year. Accordingly, the Amendment prevents external directors from favoring the controlling shareholders, arising out of their expectation to receive certain benefits in the future services.

Chief Executive Officer as Chairman of Board

The Amendment purports to reinforce the separation between the position of a company's chief executive officer and that of chairman of the board of directors in public and debenture companies. The appointment of a chief executive officer and a chairman of the board who are relatives shall require a special majority of votes at the shareholders' meeting,[146] as follows: (i) the majority shall include at least two thirds of the votes of the non-interested Shareholders who are present at the vote; abstained votes shall not be taken into account, or (ii) the total number of the opposing non-interested Shareholders does not exceed 2 percent of the total voting rights in the company.[147]

In addition, the authorities of the chief executive officer shall not be vested with the chairman or his relative (unless the approval of a special majority as specified above has been obtained) and the authorities vested with those subordinated to the chief executive officer may not be vested with the chairman of the board of directors. The chairman of a public or a debentures company shall not serve in any other position in the company or in a company controlled thereby, excluding his office as a director or chairman of the board of a controlled company.

Director's Discretion

The Amendment states that a person may not perform any function of a director if he was not duly appointed and that a director (i) shall exercise his voting rights in the board of directors based on his sole discretion only and (ii) shall not be a party to any voting agreement. Any voting agreement or non-exercising of his discretion shall be deemed a breach of the director's fiduciary duty.[148] The person affecting director's discretion in violation of the said provision shall be

145 Companies Law, s 249 (a).
146 Companies Law, s 95.
147 Companies Law, s 121 (c).
148 Companies Law, s 106.

subject to the duties and liabilities that apply to directors (the duty of care and fiduciary duty).

Independence of Audit Committee

The board of directors of a public or debenture company shall appoint an audit committee, composed of the members of the board.

Audit Committee — Composition

Prior to the Amendment, the Companies Law determined that the audit committee should consist of at least three directors, including all of the company's external directors. The Amendment augmented the independence of the audit committee by adding requirements that (i) the majority of the members of the audit committee shall be unaffiliated directors,[149] (ii) the quorum for its meetings is to include a majority of independent directors[150] and (iii) the chairman thereof shall be an external director.[151]

Furthermore, the chairman of the board and any director employed by a company or by the company's controlling shareholder, directly or indirectly, or providing services to any of them on a regular basis, shall not serve as a member of the audit committee. Another provision intended to augment the independence of the audit committee is that any person who is not qualified to serve as a member of the audit committee shall not be present at its meetings and at the time resolutions are adopted thereby, unless the chairman of the audit committee determined that such person's participation is required in order to present to the committee a particular matter.

Audit Committee — Roles

The authorities and roles of the audit committee were significantly broadened in the Amendment. The audit committee is expected, *inter alia*, to identify irregularities in the management of the company's business and propose solutions for improvement thereof. In the event such material irregularity has been identified, the audit committee is required to convene to discuss same in the presence of the company's internal auditor or the independent auditors of the

149 Unaffiliated director means an external director or an individual serving as a director who meets all of the following: (i) he fulfills the requirements with regard to an external director set forth in Sections 240 (b) – (f) of the Companies Law and the same was approved by the audit committee, and (ii) he does not serve as a director in the company for more than 9 consecutive years (for this purpose a cessation of office for less than 2 years shall not be deemed as cutting off the continuance of the office).

150 Companies Law, s 116A.

151 Companies Law, s 115.

company, provided that company officers who are not members of the committee shall not be present.

A company's extraordinary transactions and material actions that involve conflicts of interests, or interested parties' transactions in accordance with Sections 255-268 and 275 of the Companies Law, are subject to the approval of the audit committee, as specified hereinabove.

The audit committee is also authorized to define whether a transaction is an extraordinary transactions and whether a transaction with company's officer is a material one, provided it specifies the reasons for its classification of a transaction as extraordinary or material, or as a non-extraordinary or non-material. The audit committee supervises the mechanism of the company's internal audit, and advises the board of directors with regard to the company's independent auditor and its compensation.

Procedures in Board Meetings

Boards of directors of public and debenture companies shall convene at least quarterly. The Amendment determined certain provisions regarding the procedures for convening board meetings. For example, a public and/or debenture company shall not impose any conditions or restrictions in its articles of association on the requirement to (i) provide the directors with reasonable prior notice on convening a meeting and (ii) provide in such prior notice reasonable details with regard to the issues on the agenda. Board committees shall submit their resolutions or recommendations, as well as the reasons therefore, requiring board approval at least a reasonable time prior to the contemplated board meeting.

Financial Statements Review Committee

The financial statements review committee is a board of director's committee established in accordance with Section 171(e) of the Companies Law and the regulations promulgated thereunder. In accordance with these provisions, financial statements of a reporting corporation (excluding a corporation which securities are listed for trade on a foreign stock exchange) shall be approved by a company's board of directors following: (i) the financial statements review committee has reviewed the estimates included in such financial statements, the internal controls related to financial reporting, and adequacy and completeness of the disclosures in the statements; (ii) the corporation's auditor was invited to all the meetings of the financial statements review committee; (iii) the committee delivered the board its recommendations regarding the approval of the financial statements within a reasonable time prior to the board's meeting and has specified deficiencies encountered therein, if any; and (iv) the board discussed the recommendations of the financial statements review committee.

The financial statements review committee should include at least three directors, provided that a director who is prohibited from serving as a member of the audit committee may not serve in the financial statements review committee.

Only an external director may serve as a chairman of the financial statements review committee, and the majority of its members shall be unaffiliated directors. The audit committee of a company can also serve as its financial statements review committee.

Monetary Sanctions

The Amendment empowers the Authority to impose monetary sanctions on a person that violates the provisions of the Companies Law with regard to a reporting corporation, *inter alia*, in the following cases:

- No minimum number of directors having accounting and financial expertise has been determined by a company;
- No chairman has been appointed to the board of directors for over 60 days;
- No audit committee has been established for over 90 days;
- No chief executive officer has been in office for over 90 days;
- No internal auditor has been in office for over 90 days;
- A director or an officer who has been disqualified from serving in such office by a committee for administrative enforcement, has been appointed by a company(no sanction shall be imposed if the director or the officer has not notified the company of such disqualification);
- Less than two external directors have been in office for over 90 days;
- No external director having an accounting and financial expertise has been in office for over 90 days; and
- No external director has been appointed to a committee that had been delegated any of the powers of the board of directors.

A monetary sanction may not be imposed in case an external director was not appointed due to the fact that the majority prescribed by the Companies Law was not obtained in the general meeting.

Proper Corporate Governance Code

The Companies Law recommends that companies (private or public, including debenture companies) adopt certain rules of proper corporate governance listed in Exhibit A to the Companies Law (a kind of voluntary ethical code) and further recommends to include them in the companies' articles of association.

The said list of recommended rules includes, *inter alia*, provisions with regard to appointment of unaffiliated directors and their percentage on the board of directors, diversity in the composition of the board of directors, limitations prohibiting service of a company's officers as directors, professional programs intended to improve qualification of new appointees to the board of directors and appointment of external directors. As aforementioned, although the adoption of such corporate governance provisions is voluntary, the Authority published its intention to impose an explicit requirement to adopt these provisions or,

alternatively, to report the company's resolution not to do same within the framework of the Reporting Improvement Project.[152]

Debt Arrangements

Debt Payment to Controlling Shareholder of Reporting Corporation in Difficulty

Recent Law amendments determine that a controlling shareholder of a reporting corporation in difficulties, who holds debentures issued by the corporation under his control, shall not receive the amounts owed to him by the corporation unless the corporation has repaid in full all and any amount due and payable to other debenture holders, including interest and linkage accrued thereon.[153]

For the purposes of this provision "reporting corporation in difficulties" means a reporting corporation which has announced that it is unable to pay its obligations pursuant to debentures, a reporting corporation that has not paid its obligations pursuant to debentures or a reporting corporation undergoing liquidation proceedings or asset receivership; "holding of debentures" excludes holding (i) by means of a company whose shares are held by the reporting corporation in difficulties that has issued debentures, provided that the other shareholders in such company are not controlled by a controlling shareholder of the reporting corporation in difficulties; (ii) by means of certain classes of sophisticated investors; (iii) in trust for another party, provided that the other party is not a controlling shareholder of the reporting corporation in difficulties.

The aforementioned deferral provision shall not apply if: (i) a settlement or arrangement approved by a special resolution of the holders of the debentures of the same series provides otherwise, or a settlement or arrangement approved pursuant to Section 350 of the Companies Law provides otherwise; the votes of the controlling shareholder holding the debentures shall not be counted at such a meeting; (ii) the controlling shareholder has held the debentures since they were issued for the first time.

18th Amendment to Companies Law — Appointment of Supervisor

An additional 2012 amendment to the Companies Law was recently enacted by the Knesset, intending to protect the public interests in debt arrangements of debenture companies with their debenture holders. This amendment determines that immediately upon commencing negotiations for any debt arrangement implementing a material change in terms of repayment of any company's debentures series, including reducing repayable amounts, postponement of the repayment and repayment by means of issuance of other securities to the debenture holders, the debentures' trustee, or in case the same has not been

152 See the section on Reporting Improvement Project hereinabove.
153 Securities Law, s 52N1.

appointed, the debenture company, shall submit an application to the competent court for appointment of a supervisor for such future arrangement. The trustee or the company, as the case may be, may postpone the said application in the event (i) the disclosure thereof shall adversely affect the negotiations, and (ii) the disclosure is not mandatory in accordance with the applicable law. The supervisor shall assist the parties to finalize an arrangement and shall provide the court with an opinion with regard to the agreed arrangement and alternatives thereto, addressing certain requirements and parameters specified in the amendment. The court shall not order the convening of general meetings of any series of debenture holders, prior to receipt of such supervisor's opinion. The amendment enables the court to examine and supervise the arrangement "on-line", and not *ex post facto*, and focuses upon the interests of the holders of specific debenture series.

Ownership Concentration

A new law, The Ownership Concentration Act, is undergoing legislative procedures and approvals. This act is intended to facilitate the eradication of business pyramids from the Israeli market place within six years. It prohibits a simultaneous control of a bank or other financial institution and a large non-financial company.

The privatization of government companies or state assets shall continue to be effected taking into account preventing concentration and increasing competitiveness. Rules for improving corporate governance to prevent conflicts of interest will also be enacted. It should be noted that the concentration related regulation is in its initial stage of implementation. Accordingly, it is reasonable to expect an extensive and effective regulation of this field in the seeable future.

Administrative Enforcement

In January 2011, the Law has been significantly amended by adoption of the Efficiency of Enforcement Procedures in the Securities Authority Law (legislation amendments), 5771-2011. The purpose of the amendment is to increase the efficiency of enforcement by the Authority of the laws regulating the Israeli capital market. These enforcement provisions apply to the Securities Law, as well as to the Law of Regulating Engagement in Investment Advice, Investment Marketing and Investments Portfolio Management and the Joint Trusts Investments Law. The effect of the amendment on the aforementioned laws is almost similar; the review hereinbelow focuses specifically on the effect on the Law. The major impacts of the amendment are (i) expanding the range of cases in which the Authority can impose administrative sanctions; (ii) the range of new administrative sanctions; (iii) shortening the time between a breach of the Law and the imposition of a punishment on the violator; and (iv) flexibility that enables the Authority to adjust the severity of the punishment to the significance and degree of the violation.

The main innovation of the amendment is the establishment by the Authority of a procedure for administrative enforcement through a special "Administrative Enforcement Committee" (the "Committee"), which is to investigate violations of the Law and, if required, take enforcement actions. The Committee may take the following measures, or any of them, as sanctions for administrative offenses: impose financial sanctions, instruct an offender to take actions to remedy the violation and to prevent its recurrence, prohibit offenders in certain cases from serving as a senior officer in a supervised entity for certain periods of time and suspend a license, approval or permit issued under the laws enforced by the Authority for certain periods of time.

The Committee's discussions are not adversarial, and the Committee may summon witnesses to appear before it. The required level of proof for imposing enforcement means is the same as required under civil law proceedings (more than 50 per cent). The Administrative Enforcement mechanism addresses most offenses under the Law, where the level of intent (*mens rea*) rises no higher than negligence.

Offences which are subject to administrative enforcement are listed in the Seventh Schedule to the Law and they include various classes of failures to make timely disclosure or provide information required by the Authority; breaches of disclosure requirements, including by way of misleading statements or omission of material information; acceptance of orders for securities being offered, prior to the commencement of the period defined for placing orders; non-repayment of the amounts paid on account of the securities and sale of securities underlying a specific offer at a non-uniform price. The Minister of Finance is authorized, upon the Authority's proposal or in consultation with it, and subject to approval of the Minister of Justice and the Knesset Finance Committee, to amend the Seventh Schedule.

A decision of the Authority to commence investigation is not subject to the right to a hearing prior to the decision, but hearing rights of a suspect or potential violator are built into the investigation process prior to indictment, and later in court proceedings.

Decision to Initiate an Administrative Enforcement Proceeding

If the Chairman of the Authority has reasonable grounds to believe, either based on an investigation of an alleged offence listed in the Seventh Schedule to the Law and made pursuant to Section 52QQ of the Law or otherwise, that a violation has been committed, he is authorized, by detailed decision made in accordance with the considerations stated in Section 52RR regarding such violation, to initiate an administrative enforcement proceeding and appoint a Committee panel to adjudicate the violation.

Committee — Composition

The Committee consists of six persons divided into two panels of three persons each. Two members, who are Authority employees qualified to serve as district

court judges, are to be appointed by the Authority's Chairman. The Minister of Justice is to appoint the four other members, provided that two of them shall have expertise in the capital markets and two others shall be attorneys with expertise in securities and companies' laws.

Notice of Initiation of Administrative Enforcement Proceeding

The chairman of a panel shall deliver a notice to the panel and to the violator regarding the initiation of the administrative enforcement proceeding pursuant to the Law. Such notice must specify the following: (i) details of the act constituting the violation, and a summary of the facts and circumstances thereof; (ii) the enforcement measures which may be imposed on the violator in accordance with the provisions of the Law; (iii) the violator's right to receive all the violation-related data that has been submitted to the panel by the Authority; and (iv) the violator's right to present his or her arguments to the panel.

Right to Present Arguments

A violator who received notice of initiation of an administrative enforcement proceeding is entitled to present his arguments with regard to this matter to the panel (in writing), within 45 days of the date of delivery of such notice.

Proceedings before Panel

A violator has a right to be present at all the panel's discussions during the proceeding. The violator that presented his arguments to the panel in writing also will be entitled to present the arguments orally. In special circumstances, including upon the request of the violator, the panel is authorized to invite other persons to appear before it and provide it with the information required for the purpose of its ruling; the violator is entitled to be present during the discussion to which such person has been invited, to receive information and to present his arguments orally before the panel. The party affected by a violation shall not be a party to the proceeding, although the panel may invite the injured party to appear in accordance with the aforesaid provisions.

The Panel's Ruling

The panel's ruling must be in writing, shall detail the reasons therefore, and shall be presented to the violator; a ruling imposing administrative enforcement measures shall also (i) detail the reasons for choosing those specific measures, drafted in accordance with the considerations specified in the Law with respect to the violation; (ii) include the date on which the ruling will enter into effect (in any event may not be less than 60 days following the date of the ruling), provided that different effective dates may be determined with regard to different enforcement measures.

The Court is authorised to bring forward an effective date of any enforcement measure, upon the request of the panel's chairman, if the chairman believes that the circumstances of the case justify such a change.

Imposition of Administrative Enforcement Measures

If a panel finds that a violation has been committed, it may impose on the offender one or more of the administrative enforcement measures specified in the Law; the panel will choose the enforcement measure and the degree thereof, out of the enforcement measures specified in the Law, based on the following: (i) the facts that constitute the violation; (ii) other factual circumstances that have been proven during the panel's discussions regarding the violation, including the scope of the violation, the profit it produced or the loss it prevented, and the damage caused as a result of the violation; (iii) previous violations, if any; (iv) actions taken by the violator upon the discovery of the violation, including whether the offender ceased the violation by his own initiative and reported the violation to the Authority, and whether the offender took actions in order to prevent recurrence of the violation and minimize the damage resulting therefrom; (v) the violator's personal circumstances that caused him to commit the violation or other exceptional personal circumstances; (vi) the Authority's enforcement policy.

Financial Sanction

A panel may impose on a violator financial sanctions ranging between the following: (i) NIS 400,000–1,000,000 for an individual (depending on the specific violation); (ii) NIS 2,000,000–5,000,000 for a corporation (depending on the specific violation); (iii) up to NIS 25,000 on individuals who are not senior corporate officers. These amounts are the maximum amounts that the panel can impose.

Taking Measures to Correct Violation and to Prevent Its Recurrence

A panel has the authority to instruct the violator with regard to the actions he is required to perform in order to correct the violation and to prevent its recurrence, and to order him to deposit a guarantee in order to ensure that such actions are actually performed; the deposited guarantee shall be forfeited in the event the violator does not perform the prescribed actions.

Prohibition on Service as Senior Corporate Officer in Supervised Entity

If a panel determines that it is not advisable that a person who has committed any of the offences listed in Part C of the Seventh Schedule, shall serve as a senior corporate officer of any of the entities listed below (the "Supervised Entities"), it is authorized to prohibit the violator's service as such senior corporate officer for a period not exceeding one year or, subject to the Court's approval, for a period not exceeding five years from the date on which the

panel's ruling comes into effect. The Supervised Entities include, *inter alia,* a reporting corporation and an underwriter.

Disclosure and Immediate Reporting of Decision to Impose Enforcement Measures

On the date on which a ruling becomes effective, the Authority shall publish it on its website. Upon the violator's request, the panel may in a reasoned written decision resolve not to publish the ruling, as detailed above, or may determine a delayed the date for publication thereof; however, the time that has passed since the violation has been committed may not be deemed a reason for non-publication or delay.

Unless otherwise resolved by a panel, immediately after the enforcement measures imposed by a panel on a reporting party (including, *inter alia*, a reporting corporation, a trustee for debentures and an underwriter) or on a senior corporate officer thereof, come into effect, such reporting party shall disclose the ruling to the public, by means of an immediate report.

Court's Authority on Appeal

A violator shall be entitled to submit an administrative appeal on a panel's ruling, provided such appeal is submitted within 45 days following the date on which the violator received the said ruling.

Responsibility of General Manager or Partner, Other Than Limited Partner

A general manager of, or a partner, other than a limited partner, in a corporation, shall supervise and take all reasonable measures in order to prevent the violation by the corporation or by the partnership, as the case may be, or by any of their employees. If a violation has been committed, excluding certain classes thereof expressly specified in the Law, the general manager of a company or a partner other than a limited partner in a partnership, as the case may be, will be deemed to have breached his aforesaid supervision duty and will be subject to the enforcement measures specified below, to the extent such measures could have been imposed on him if he were the offender, unless the opposite has been proven: (i) a financial sanction, in an amount that shall not exceed half of the maximum amount that could have been imposed on an individual for the same violation; (ii) with regard to a violation listed in Parts B or C of the Seventh Schedule — a suspension, for a period that will not exceed half of the period that could have been imposed on the violator pursuant to the applicable administrative enforcement provisions; (iii) with regard to a violation listed in Part C of the Seventh Schedule — a prohibition to serve as a senior corporate officer in a supervised entity, for a period that will not exceed half of the period that could have been imposed on the offender pursuant to the applicable administrative enforcement provisions.

If a corporation (i) has established procedures that are sufficient to prevent aforesaid violations, (ii) has appointed an enforcement officer in order to supervise compliance therewith, including provisions regarding the training of the corporation's employees for the purposes of such compliance, and (iii) has taken reasonable measures to remedy a violation and to prevent its recurrence, the general manager or partner, as the case may be, shall be deemed to have fulfilled his supervision duty.

Misleading Authority

If a supervised party has caused a misleading item to be presented to the Authority in any report, document or notice, required to be submitted pursuant to any law, the Authority's demand or demand of an authorized Authority's employee, provided such supervised party should have known that the presentation could mislead the Authority, such supervised party shall be deemed to have committed an offence listed in Part C of the Seventh Schedule.

Non-Prosecution Agreement

This mechanism was also introduced under the administrative enforcement reform described under Principle 8. It enables the Authority (and the District Attorney) to impose sanctions on securities offenses and administrative violations with the consent and cooperation of the offender.

Criteria for Recognition of Internal Enforcement Program in Securities and Asset

Management Field

In August 2011, the Authority published Criteria for Recognition of an Internal Enforcement Program in the Securities and Asset Management Field (the "Criteria"). The Criteria are intended to provide a certain balance and counter measure to the increased liability imposed on chief executive officers (CEOs) and other officers and directors.

Subject to certain requirements specified therein, the Criteria allows the Authority deem an internal enforcement program as a viable defense claim against potential enforcement procedures. The Criteria are relevant to all issuers and Authority's-regulated entities. An internal enforcement program is a voluntary mechanism adopted and implemented by a corporation on an ongoing basis in order to ensure that the corporation and its units comply with the provisions of the Law, the Mutual Fund Law, and the Investment Advice Law. The adoption of an internal program is not mandatory however, the Authority will examine whether such program was adopted by a corporation, and shall specifically review its effectiveness (i.e. its suitability for the specific circumstances relating to the specific corporation) in the event of suspected violations. The enforcement program is expected to promote the development of an environment of compliance within the company. While examining the

efficiency of the program the Authority shall address not only the written procedures contained therein but also their effective implementation. In exercising its legal enforcement powers, the Authority may give credit to a company implementing an effective enforcement program or individuals within that company, in the event of a breach of the Law.

Dividend Distributions by Financially Unstable Companies.

International Financial Reporting Standard 9. As part of its effort to prevent unstable companies from making dividend distributions that could jeopardize their ability to meet their obligations to debenture holders, the Authority has recently imposed comprehensive disclosure requirements for early adopters of International Financial Reporting Standard 9 (IFRS 9), which is expected to increase profits deemed distributable through dividends.

Under the Companies Law, a corporation is entitled to distribute dividends from retained earnings reflected in the financial statements without court approval. Accordingly, companies may distribute a large part of their equity as a dividend, based on notional profits arising from adoption of the new IFRS 9 accounting rule.

Attributing the investment results to other comprehensive income, which is permitted under IFRS 9, can keep losses derived from financial instrument investments from being included in net income of a company, even after the investment is sold and the loss realized. Excluding the loss from the bottom line raises the company's dividend distribution potential.

The Authority is seeking to verify that dividend distributions are performed on the basis of real profits and to restore the profit test, set forth in the Companies Law as a basis for distribution,[154] to its original purpose of determining if the company's cash flow can sufficiently cover the distribution.

The Israeli Ministry of Justice has announced its plans for enacting new regulations under Section 302 of the Companies Law stating to the effect that a company's surplus in capital equity will also include losses arising from financial capital assets, thereby negating the effect of IFRS 9.

Expected Amendment to the Companies Law. Another element of the campaign to prevent financially unstable companies from distributing dividends that might prevent them from meeting their financial liabilities is the recently issued draft of Companies Law regulations intended to prevent the distribution of virtual profits based upon the implementation of IFRS 9.[155]

The Regulations are expected to determine that a company's retained earnings include losses from financial capital assets whenever such a loss was recognized

154 Companies Law, s 302.

155 Companies Regulations (amounts included in capital equity for the purposes of determination of surplus) – 2012.

due to a substantial and prolonged decline in the fair value of a financial asset under accounting standards in force prior to IFRS 9.

In addition, the Companies Law is expected to be amended to provide that tests set by the law on dividend payouts will relate to the company's overall earnings net of unrealized profits that consequently do not reflect any cash flow.

Companies that comply with IFRS 9 and designate any financial instruments to "other comprehensive income" are required by the Authority to show distributable retained earnings in their financial statements, at any time they resolve on a dividend payout. They are also required to disclose the balance of distributable retained earnings in the absence of IFRS 9, with a full breakdown and explanation of any adjustments between the two amounts.

The disclosure and explanatory obligation is also imposed on the board members of a company that distributes profits in case of compliance with the requirements of the test only by virtue of IFRS 9. In such case, the company is required by the Authority to disclose its board's reasons for the existence of distributable earnings in accordance with the dividend distribution tests as set out in the Companies Law. The board shall also disclose the major assumptions underlying its resolution to distribute the dividend, including a professional opinion, value assessment and the cash flow projections used as the basis for approving the distribution.

Insider Information

Definitions

Under Chapter H1 of the Law, regulating the issue of insider information, the following definitions apply:

- A ‘company’ is a corporation whose securities have been offered to the public under a prospectus or are traded on the Stock Exchange, and held by the public, including a subsidiary and an affiliate thereof;
- ‘Insider information’ is information on actual or expected developments in a company, changes in its state of affairs, or any other information on the company, which is not known to the public and which, if disclosed to the public, would cause a significant change in the price of the company’s securities or the price of other securities for which the company’s security serves as the basic-asset;
- An ‘Inside person’ in a company is (a) a director, general manager, principal shareholder, or other person whose status or position in, or relationship with, the company gives him access to insider information on the effective date (the date on which the insider information has been used) or within six months prior thereto, (b) a relative of one of those listed in item (a), and (c) a corporation controlled by one of those listed in items (a) and (b);

- A 'Principal shareholder' in the company is a shareholder holding five per cent or more of the par value of the company's issued share capital or of the voting power, or having the power to appoint one or more directors;[156] and
- A 'Transaction' encompasses the sale, purchase, or conversion of security, subscription to a security, or an undertaking to perform any of these, whether the person performing it acts for his own benefit or for the benefit of others, even if he acts by means of a proxy or trustee.

Use of Insider Information

In General

Whoever performs any of the following shall be deemed to have made use of inside information:

- Effects a transaction with respect to a security of a company, excluding a security of a subsidiary or an affiliate which has not issued securities to the public under a prospectus or whose securities are not traded on the Stock Exchange, or effects a transaction in other security for which the company's security serves as the basic-asset, while being in possession of inside information or while the company is in possession of inside information; and
- Delivers, while being in possession of insider information, insider information or an opinion on a security of the company or on other securities for which the company's security serves as the basic-asset to a person who he knows, or has reasonable grounds to believe, will use the insider information or the opinion for the purpose of a transaction or will transfer it to third party.

A corporation shall be deemed to have access to insider information, or to be in possession of insider information, if a director or employee of the corporation has access to or holds such information, unless:

- The corporation has established and properly disclosed directives, pursuant to which (a) a director or employee engaged by the corporation in transactions in securities or in providing opinions or advice in connection with securities shall not be employed by the corporation in a position providing access to insider information, (b) a director or employee which holds insider information shall not effect a transaction on behalf of the corporation, with regard to securities of the company or with regard to other securities for which the company's securities serve as the basic-asset, to which the insider

156 A 'holding' means alone or together with others, whether directly or indirectly, by means of a trustee, trust company, or registration company or in any other manner; in case of holding by a company, this also refers to holding by its subsidiary; in case of holding by an individual - holding by an individual and by his family members residing with him, or supporting one another, shall be deemed holdings of one person. 'Holding securities with others' means holding of securities by two or more parties pursuant to an agreement, whether written or oral.

information relates, and shall not provide an opinion or advice in connection therewith, (c) a director or employee as set forth in item (b) shall not transfer the insider information in his possession to a person who he knows, or has reasonable grounds to believe, will make use thereof for the purpose of effecting a transaction or providing an opinion, or will transfer to third party, (d) a director or employee as aforesaid in item (b) shall not transfer the insider information in his possession to any other person even if not included in item (c), unless it is necessary for performance of his duties in the corporation; and

- The required arrangements have been made by a corporation to ensure compliance with the directives set forth above, and there are internal controls guaranteeing fulfillment thereof.

Use of Information by Inside Person

An inside person in a company shall not make use of insider information. Violation of such prohibition by an inside person in a company is punishable by five years' imprisonment or a fine, provided that in the event the insider is a corporation, the fine imposed on it shall be significantly higher.

Use of Information Originating from Inside Person

A person may not make use of insider information which has been received, directly or indirectly, from an insider person in a company. Violation of such prohibition is punishable by imprisonment for two years or a fine, provided that in the event the insider is a corporation, the fine imposed on it shall be significantly higher.

Presumption as to Use of Inside Information

If a key insider in a company purchases securities of a company in which he serves as such, or other securities, for which the company's securities serve as basic-asset securities, within three months following the date on which he sold securities of such company, or sells such securities within three months following the date on which he purchased them, such purchase or sale will be *prima facie* evidence that he made use of insider information in his possession, unless he proves that he had no insider information in his possession on the date of the sale or purchase, or that, under the circumstances of the case, it is reasonable to assume that he had no insider information in his possession on that date.[157]

157 A 'company's key insider ' is (i) a director, general manager, assistant general manager, deputy general manager, comptroller, and internal auditor, and anyone fulfilling such position under any other title, as well as an individual who is a main shareholder in the company;(ii) a relative of any person listed in subsection (i) hereinabove; or a corporation under the control of any of person listed in subsections (i) and (ii).

Information Not Regarded as Inside Information

In General. Information shall be deemed not to constitute inside information if a report regarding the information has been submitted to the Authority or the Stock Exchange, and the Authority or the Stock Exchange published it, or the same has been published in any other customary way for the purpose of bringing such information to the knowledge of the public, and one trading day on the Stock Exchange has passed after the day of such publication.

If the Authority or the Stock Exchange does not publish the information within four days following the day it was reported, the information shall cease to be insider information at the end of that period. Whoever claims that the information was submitted or published as aforesaid, bears the burden of proof thereof.

Defenses. A person shall not be criminally liable or be liable to pay the fines as set forth above or to refund the profits gained from the use of insider information as set forth below, if he proves one of the following:

- The sole purpose of the transaction effected by him was to purchase qualifying shares which, under the company's articles, a director is required to purchase as a condition of his appointment;
- The transaction effected by him is a good-faith act performed in his capacity as liquidator, receiver, or trustee in bankruptcy or to exercise collateral;
- The transaction in question is a good-faith execution of an underwriting contract;
- The purpose of using the insider information was not, or was not primarily, obtaining of profit or prevention of loss for himself or another;
- The person entered into the transaction in connection with the company's securities on which he has insider information or with regard to other securities, for which the company's securities serve as basic-asset securities as third party's agent, without exercising his own discretion and without providing information or an opinion which could have led to entering into the transaction;
- The transaction was effected outside the Stock Exchange with a person who was also in possession of the inside information;
- The transaction was executed for an inside person by a trustee acting by way of a blind trust;[158] or
- Under the circumstances of the case, there was justification for performing the transaction.

158 A 'blind trust' is one exercised at the sole discretion of the trustee without intervention by the inside person.

A corporation will not be criminally liable and will not be liable to pay the fines as set forth above or to refund the profits gained from use of the insider information as set forth below, although its director or employee has access to the insider information or has possession of insider information concerning the corporation whose security or other securities, for which the company's securities serve as basic-asset securities is the object of the transaction or the opinion, if it proves that neither the director nor the employee holding the insider information decided to enter into the transaction or to provide the opinion, and there is a reasonable explanation for effecting the transaction or providing the opinion.

In 2010 the Authority published a 'Safe-Harbor' directive intended to reduce exposure to violations of prohibitions upon use of insider information in the event of a company acquiring its own securities. A corporation acquiring its own securities shall be deemed to comply with such safe harbor requirements if it complies with the following requirements: (i) the corporation's board of directors has approved in advance a detailed acquisition plan, in the form of an "automatic pilot" self-acquisition plan includes certain features, such as a fixed amount of securities to be purchased or aggregate sum to be used thereunder, prices and specific dates for their purchase or a formula for determining same; (ii) the plan shall be implemented by an independent stock exchange member, which has no material business relationship with the corporation; (iii) the performance of the plan is irrevocable; and (iv) the plan shall be implemented only after the second trading day following the publishing of the financial statements on the basis of which such plan was approved. The forgoing directive applies only to corporations and not to individuals, i.e. principal and controlling shareholders or officers. Furthermore, a corporation that fails to comply with the reporting requirements of the Law and has purchased its securities during the period of such incompliance shall not enjoy the said safe harbor defense.

Profits from Use of Insider Information. A company whose securities were the object of a transaction effected using the insider information, has the right to claim the profits accrued from the transaction by the person who made use of such information.[159]

Transactions with Securities by Stock Exchange Employee. An employee of a Stock Exchange member may neither purchase nor sell securities except during the ordinary course of trade on the Stock Exchange, pursuant to written instructions given at least one day prior to effecting the purchase or the sale.

An employee of a Stock Exchange member shall hold his securities in a portfolio in his name with the Stock Exchange member. A director or employee of a Stock Exchange member effecting transactions in securities on behalf of

159 'Profit' is the difference between the actual price of the security in the transaction and the price thereof immediately after the insider information became known to the public.

others shall give written instructions solely through that Stock Exchange member; if the Stock Exchange member has more than one branch, he shall give the instructions at the branch at which he is employed.

Any other Stock Exchange member's employee shall give all his instructions through a single Stock Exchange member only; if such Stock Exchange member has more than one branch, he shall give the instructions at one branch only, i.e., in which his securities portfolio is managed.

The Minister of Finance, after consultation with the Securities Authority and with the approval of the Knesset Finance Committee, is entitled to prohibit trading in securities by the employees of a Stock Exchange member, either generally or in respect of certain types of employees of Stock Exchange members or of securities or any other classification, as well as to define the term "trade" for this purpose.

Existence of Transaction. No transaction shall be void only because its execution constitutes violation of the abovementioned provisions.

Purchase Offers

In General

Purchase offers are regulated by the Companies Law, within the framework of two separate sections. The procedural and the reporting aspects related thereto are governed by the Purchase Offer Regulations.[160]

The Companies Law, sets forth detailed arrangements with regard to the execution of a special purchase offer in a public company,[161] a full purchase offer in a public company (and also in a private company), and various aspects which derive from the execution of each one of the purchase offers, as specified below.

Special Purchase Offers

Acquisition of Control Block

In a public company, an acquisition shall be exercised only by way of a purchase offer in accordance with the provisions set forth below[162] ('special

160 Securities Regulations (Purchase Offer), 5760-2000.

161 A company whose shares are registered for trading on the Stock Exchange or which have been issued to the public in accordance with a prospectus, within the meaning of such term in the Law, or which have been issued to the public outside of Israel in accordance with a public offer document, required by the local non-Israeli law, and which are held by the public.

162 These provisions will apply to a special purchase offer, in addition to the provisions of any law governing purchase offers, in so far as there is no contradiction between them and these provisions.

purchase offer') if (i) as a result of an acquisition a person becomes the holder of a control block of shares (25 per cent or more of all the voting rights in the general meeting), provided there is no other holder of a control block of shares in the company; and (ii) as a result of an acquisition the shareholdings of the acquirer will increase to 45 per cent of the voting rights in the company, provided there is no other person who holds more than 45 per cent of the voting rights in the company. The special purchase offer provisions shall not apply to:

- Acquisition of shares in the course of a private offering, provided that the acquisition was approved at a general meeting as a private offering intended to provide the offeree a control block of shares if there is no holder of a control block of shares in the company, or as a private offering intended to provide 45 per cent of the voting rights in the company if there is no other person in the company who holds 45 per cent of the company's voting rights;
- Purchase from the holder of a control block of shares, as a result of which a person becomes the holder of a control block of shares; or
- Purchase from a holder of more than 45 per cent of the voting rights in the company, as a result of which the purchaser's holdings percentage will exceed 45 per cent of the voting rights in the company.

Opinion of Board of Directors

In the event that a special purchase offer has been made, the board of directors of the company whose securities are to be purchased ('the target company') will provide the offerees its opinion with regard to the advantages of the special purchase offer, or it will refrain from providing its opinion in the event it is unable to do same, provided that it reports the reasons for refraining. Furthermore, the board of directors will disclose any personal interest any of the directors have in the purchase offer or arising therefrom.

Obligations of Officers

An officer in the target company who by virtue of his position performs an action (excluding negotiating with the offeror to improve the terms of his offer and negotiating with others for competing purchase offers) intended to cause the special existing or expected purchase offer to fail, or to adversely affect the chances of its being accepted, shall be liable towards the offeror and the offerees for their damages due to his activities, unless he acted in good faith and had reasonable grounds to believe that his actions are in the company's best interest.

Agreement of Shareholders for a Special Purchase Offer

A special purchase offer shall be addressed to all the offerees, and the offerees are entitled to give notice of their agreement or objection thereto.

A special purchase offer must be accepted by a majority of the offerees who have notified of their position in relation thereto. The vote of (i) the controlling

shareholder in the offeror, (ii) whoever has a personal interest in accepting the special purchase offer, (iii) the holder of the control block in the company, or (iv) a party who acts on behalf of those stated in items (ii) and (iii) herein or of the offeror, including their relatives or corporations under their control, shall not be taken into account when counting the votes of the offerees. As mentioned above, each shareholder participating in the vote must notify the company prior to the vote whether he has a personal interest in the approval of the special purchase offer.

Late Response Option

In the event that a special purchase offer was accepted, the offerees who had refrained from announcing their position in relation to the purchase offer or had objected thereto, are entitled to agree to the offer, within four days following the last date for acceptance of the purchase offer, and they will be deemed to have initially accepted the offer.

Minimal Response

A special purchase offer will not be accepted unless shares which accord at least five per cent of the voting rights in the company have been acquired thereunder.

Consequences of Prohibited Acquisition

The shares of a public company which have been acquired in contravention of the provisions of the special purchase offer specified above, will not accord any rights whatsoever and they will be dormant shares for so long as they are held by the acquirer.

Without derogating from the above, in the event that the voting rights of any party increased to the rate (i) which provides him a control block if there is no holder of control block in the company, or (ii) which exceeds 45 per cent of the voting rights in the company if there is no other person who holds more than 45 per cent of the voting rights in the company as a result of the company's shares being dormant due to distribution, but excluding the increase in holdings resulting from purchase by means of a special purchase offer,[163] then voting rights will not be accorded to shares exceeding the rate of 25 or 45 per cent, as the case may be, for so long as such shares are held by such person. A shareholder will

163 The distribution of a dividend or an undertaking to distribute a dividend, directly or indirectly, and also purchase or the giving of financing for purchase, directly or indirectly, by the company or by its subsidiary company or by some other corporation which is under its control, of shares of the company or of securities which are convertible into shares of the company or which are capable of being realised in the shares of the company or redemption of redeemable securities, which are part of the company's share capital according to the Companies Law, and including an undertaking to carry out each one of these, provided that the seller is not the company itself or another corporation fully owned by the company.

inform the company of shares held by him, which do not convey voting rights, as soon as possible after he was informed of same.

Subsequent Purchase Offers and Subsequent Mergers

In the event that a special purchase offer was accepted, the offeror, the person that controlled the offeror on the date of the offer, and any corporation under their control will not make any additional purchase offers for purchase of the company's shares, for a period of a year following the date of the purchase offer, and they will not carry out a merger with the company unless they undertook to do so in the special purchase offer.

Regulations

Provisions regarding the procedure of a special purchase offer, including the ways for delivery thereof to offerees and receipt of their positions, voting instruments and dates are determined in regulations enacted by the Minister of Justice.[164]

Public Companies Whose Shares Are Traded on Stock Exchange Outside Israel

The provisions specified above will not apply to a special purchase offer, in the event that (i) in accordance with the law of the foreign country (the law of the country in which the securities were offered to the public or in which the securities are registered for trading on the stock exchange, including rules and assumptions which are practised in the said stock exchange) a restriction applies to the purchase of control in a company, at any rate, (ii) the purchase of control at any rate requires the acquirer to make a purchase offer to all public shareholders, (iii) it is a public company the shares of which have been offered to the public outside of Israel[165] only or they are registered for trading outside of Israel only, and (iv) it is a company which was incorporated prior to the 1st of February 2000 (the time Companies Law came into force), and its shares were registered for trading in Israel after this date.

Full Purchase Offer — Purchase of the Minority Shares

Full Purchase Offer. Purchase of voting rights, shares or a class of shares in a public company may not be performed if following the purchase the acquirer will hold more than 90 per cent of the shares of the company or of a class of shares, as the case may be, other than by way of a purchase offer for the entirety of shares or a class of shares ("full purchase offer"), which shall be approved in accordance with the provisions specified below.

164 Securities Regulations (Purchase Offer), 5760-2000.

165 Companies Regulations (Relief to Public Companies Whose Shares are Listed for Trading Outside Israel), 5760-2000.

In the event that a person holds shares at a rate higher than 90 per cent of the entirety of shares or the class of shares of a public company, he will not acquire additional shares for so long as he holds shares at the said rate (unless and to the extent otherwise detailed in the full purchase offer).

If, at 1 February 2000, a person held shares at a rate higher than 90 per cent of the entirety of shares or the class of shares of the public company, according to the applicable law prior to the said date, he will not purchase additional shares other than by way of a full purchase offer, to be accepted by the offerees, in a manner that the percentage of shares held by the offerees which did not accept the offer is less than one half of the company's issued share capital, or of the issued capital of the class of shares as to which the offer has been made. If a full purchase offer is accepted, the entirety of shares the offeror wishes to acquire shall be transferred to his possession, and the shareholders' register shall be amended accordingly.

Acceptance of Full Purchase Offer and Forced Sale of Shares. The execution of a full purchase offer is subject to obtaining the minimum statutory acceptance rate among the offerees, as determined in the Companies Law.[166] In the event that (i) the rate of the holdings of the offerees who did not respond to a full purchase offer constitutes less than five per cent of the company's issued share capital or of the issued capital of the class of shares with regard to which the offer was made, and (ii) more than one half of the offerees who have no personal interest in accepting the offer, have accepted it, then the entirety of the shares which the offeror intended to acquire will pass into his ownership and the registrations of the shares' ownership will be changed accordingly. As mentioned above, each shareholder participating in the vote must notify the company prior to the vote whether he has a personal interest in the approval of the full purchase offer. Notwithstanding the foregoing, the full purchase offer shall be deemed accepted if the holdings' rate of the offerees who voted against the offer is less than two per cent of the company's issued share capital or of the issued capital of the class of shares with regard to which the offer was made. In the event that the full purchase offer has not been accepted, the offeror will not acquire, from offerees who have accepted the offer, shares which will accord to him a holding of more than 90 per cent of the entirety of the shares in the company or of the entirety of the class of the shares with regard to which the offer has been made (unless and to the extent otherwise detailed in the full purchase offer). If a full purchase offer has been accepted, and the offeror had also offered to purchase any and all securities of such company, the provisions detailed above shall apply, *mutatis mutandis*, to any class of securities, with respect to the purchase offer of such securities.

Remedy of Valuation for Shares of the Company. The court is entitled, upon the request of any party who was an offeree in a full purchase offer which has been

166 Companies Law, s 337.

accepted, such request to be submitted not later than six months following the acceptance of the full purchase offer, to determine that the consideration for the shares was less than their fair value, and that the fair value, as determined by the court, must be paid.

An offeree in a full purchase offer is entitled to seek submission of an application for the remedy of valuation as mentioned in a class action, and he is also entitled to request the Authority to bear his expenses. In the event that the Authority has been persuaded that the action is of public interest and that there is a reasonable chance that the court will approve same as a class action, it may bear the expenses of the plaintiff, in such amount and on such terms as it will determine. In the event that the court adjudicates in favour of the plaintiff, the court may instruction to reimburse the Authority in respect of its expenses. In its full purchase offer the offeror is entitled to determine that an offeree who accepted the full purchase offer which has been accepted, shall not be entitled to remedies specified herein, provided that any information to be published under any law in connection with the full purchase offer, has actually been published by the offeror or by the company prior to offer's response date. If a full purchase offer has been accepted, and the offeror also had offered to purchase any and all securities of such company, the provisions of this paragraph shall apply, *mutatis mutandis*, to any type of securities, with respect to the purchase offer thereof.

Conversion of Public Company into Private Company. In the event that a full purchase offer has been accepted in accordance with the provisions specified above, and the offer was for the single class of the company's shares or for all classes of the company's shares, which are in the possession of the public, the company will convert into a private company.

In accordance with the provisions of Stock Exchange Regulations,[167] in the event that a full purchase offer has been duly accepted, the shares of the company will be de-listed from the Stock Exchange immediately after receipt of the notice that the full purchase offer was accepted. In this case, the securities which are convertible into a security which has been de-listed will be de-listed as well, with the exception of certificates of undertaking which are convertible into such security.

Termination of Reporting Obligations in Accordance with Securities Law. Section 36 of the Securities Law determines that obligations of reporting to the Authority are imposed on a corporation, securities of which have been offered to the public in accordance with a prospectus, for so long as its securities are in the possession of the public, and obligations of reporting to the Authority and to the Stock Exchange are imposed on a corporation for so long as its securities are traded on the Stock Exchange or are registered at the Stock Exchange for trading. Accordingly in the event that a full purchase

167 The fourth part of the Stock Exchange Regulations and the directives in accordance therewith.

offer has been accepted, the statutory obligations of reporting to the Authority and to the Stock Exchange in accordance with the Securities Law and the Regulations will terminate.

Consequences of Prohibited Acquisition. Shares which have been acquired in contravention of the provisions of a full purchase offer, as mentioned above, will not accord rights and they will automatically become dormant shares (that do not accord any rights whatsoever), for so long as they are held by the acquirer.

Breach of the provisions of a special purchase offer and the provisions of a full purchase offer specified hereinabove, constitute breach of the legal obligation towards shareholders of a company (which also constitutes a tort of damages in accordance with the Civil Wrongs Ordinance).[168]

Purchase Offer

The purchase offer regulations[169] determine the procedural aspects of a purchase offer, including, *inter alia*, the ways of its execution and acceptance, as well as the reporting aspects thereof, including the approach of the offeror to all the holders of the class of securities to be purchased, which should be made by means of written specifications.

The Regulations define an additional category of purchase offers — an ordinary purchase offer — in addition to those categories of purchase offers which have been defined in the Companies Law as specified above (special purchase offer and full purchase offer). The scope of the required disclosure in the purchase offer specification is quiet expansive, and includes provisions with regard to specifications of self-purchase of shares' offer.

168 The Civil Wrongs Ordinance (New Version), s 63 provides as follows: "Failure by any person to perform a duty imposed on him by any act of legislation other than this Ordinance shall be deemed a breach of a statutory duty, provided that (i) an act is, by a proper construction thereof, intended to be for the benefit or protection of any other person, whereby such other person suffers damage of a kind or nature contemplated by such act, and (ii) such other person will not be entitled by reason of such failure to any remedy specified in this Ordinance if, on a proper construction of such enactment, the intention thereof was to exclude such remedy." The Civil Wrongs Ordinance (New Version), s 63.

169 Securities Regulations (Purchase Offer), 5760-2000.

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Italy

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Introduction

Regulatory System and Legal Sources

Italian securities regulations are provided for by the Consolidated Text of the Rules on Financial Brokerage, approved by means of Legislative Decree Number 58 of 24 February 1998 (the 'Consolidated Text), as amended.

The Consolidated Text has replaced and repealed all the Italian rules on financial services and products previously in force. These rules include, without limitation, those governing:

- The regulated markets of transferable securities;
- The duties of the listed companies and the offers of securities;[1]
- The negotiation of unlisted securities;[2]
- The Italian investment funds and the offer in Italy of European Union (EU) undertakings of collective investment in transferable securities (UCITS);[3]
- The centralized administration of financial instruments made by Monte Titoli SpA;[4]
- The organization and the existence of Italian investment firms, denominated as 'securities brokerage firms'[5] and the operations in Italy of foreign investment firms;[6]
- The organization and the existence of Italian SICAVs;[7]
- The offer in Italy of non-EU collective investment schemes;[8]
- The tender offers for purchase and exchange and takeovers;[9] and

1 Law Number 216/74.
2 Law Number 49/77.
3 Law Number 77/83.
4 Law Number 289/86.
5 Law Number 1/91.
6 Legislative Decree Number 415/96.
7 Legislative Decree Number 84/92.
8 Bank of Italy Resolution of 31 October 2001.
9 Law Number 149/92.

- Certain aspects of privatizations.

In addition, the Consolidated Text has regulated a number of matters for the first time, such as the proxy solicitation or the organization and the existence of certain companies, denominated 'savings management companies', which are entitled to manage investment funds as well as investment portfolios, ie, to carry out the asset management activity either on a collective or on an individual basis. The complete list of the matters regulated by the Consolidated Text is the following:

- Definitions and powers of the supervisory authorities;
- Entities qualified to render investment services (ie investment firms) and general provisions on the rendering of certain investment services;
- Asset Management companies;
- SICAVs and SICAFs;
- Master-feeder structures for collective investment schemes;
- EU management companies, EU Alternative Investment Funds Managers governed by the AIFMD (AIFMs) and non-EU AIFMs;
- Marketing in Italy of UCITS and Alternative Investment Funds (AIFs) managed by AIFMs;
- Powers of the regulators *vis-à-vis* intermediaries in case of violations by intermediaries;
- Regulated markets, multilateral trading facilities, and systematic internalizations;
- Centralized administration of financial instruments;
- Public offers of financial products, ie, notices to the supervisory authorities and prospectuses;
- Private placements of financial products and exemptions from the prospectus obligations;
- Tender offers for purchase and exchange;
- Disclosure of corporate information, including holdings in Italian listed companies;
- Proxy solicitations and powers of minorities;
- Insider trading; and
- Criminal and administrative sanctions.

The Consolidated Text was amended in August 2007 in order to implement in the Italian legal system Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID).The method followed by Italian lawmakers and regulators in the implementation of

MiFID strictly follows the 'level playing field' approach in the sense that MiFID has been transposed by reproducing to the widest possible extent the text of its provisions (and, where appropriate, those of Commission Directive 2006/73/EC of 10 August 2006, the 'Level 2 Directive').

Additional requirements, especially with respect to the provisions of the Level 2 Directive, can be introduced by Italian regulators only in exceptional cases in which such additional requirements are objectively justified and proportional on the basis of the necessity of managing certain specific risks — which are not adequately considered by the EU rules — related to the protection of the investors and the integrity of the markets. Such risks must be particularly relevant in consideration of the structure of the Italian market or which become evident after the issue of the EU rules governing certain matters. The Consolidated Text has been amended by:

- Legislative Decree Number 47 of 16 April 2012, in connection with the transposition in Italy of Directive 2009/65/EC on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS IV) in order to allow the regulator-to-regulator passporting procedure for UCITS funds;
- Decree Law Number 179 of 18 October 2012, coordinated with conversion Law Number 221 of 17 December 2012, concerning Regulation Number 236 of 14 March 2012 of the European Parliament and of the Council, on short selling and certain aspects of credit default swaps (the 'Short Selling Regulation); and
- Legislative Decree Number 184 of 11 October 2012, in connection with the transposition in Italy of Directive 2010/73/EC, amending Directive 2003/71/EC on the Prospectus to be published when securities are offered to the public or admitted to trading and Directive 2004/109 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

The Consolidated Text also has been amended by Legislative Decree Number 44 of 4 March 2014, in connection with the transposition in Italy of Directive 2011/61/EC of the European Parliament and of the Council on Alternative Investment Fund Managers (AIFMD) and by Legislative Decree Number 53 of 3 March 2014, in connection with the transposition in Italy of Directive 2011/89 EU of the European Parliament and of the Council, amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC, and 2009/138/EC, as regards the supplementary supervision of financial entities in a financial conglomerate.

This chapter will follow the structure of the Consolidated Text, as outlined above, to describe the system of the Italian securities regulations. Within this context, more details will be given on those aspects of the Consolidated Text involving 'transnational' elements, consisting of investment services or products being rendered or offered respectively in Italy by foreign entities, either on a crossborder basis or through the establishment of branches.

From a legislative technique standpoint, the Consolidated Text is a statute issued by the government on delegation granted by the Parliament. One of the characteristic features of the Consolidated Text is to establish general regulatory criteria in relation to the matters listed above, while the Italian regulators in the securities industry (mainly, the Bank of Italy, the Ministry of Economy and Finance, and the National Commission for companies and the Stock Exchange, but also, for pension funds, COVIP and, for insurance financial products, IVASS, formerly ISVAP) implemented, by means of administrative regulations, the rules of the Consolidated Text governing various matters.

The most important regulations which have been issued by the Ministry of Economy and Finance, the Bank of Italy, the National Commission for Companies and the Stock Exchange, or jointly by the National Commission for Companies and the Stock Exchange and the Bank of Italy for the implementation of the Consolidated Text include:

- The establishment of 'savings management companies' (as described above) and their internal organization;
- The requirements for Italian investment funds and SICAVs;
- The registration in Italy of the foreign 'harmonized' investment funds (UCITS) and AIFs;
- The requirements and the formalities for the services rendered by the investment firms, conflicts of interest, and inducements;
- The rendering of financial services in Italy by foreign investment firms, companies managing UCITS or AIFs, or banks, either on a crossborder basis or through branches;
- The offer of securities in Italy and the drafting of the prospectuses for the various types of financial products which are offered;
- The organization of the Italian AIFs and of other special investment funds;
- The disclosure of qualified holdings in listed companies or held by listed companies;
- The disclosure of shareholders' agreements;
- The placement 'at distance' of securities;
- The advertisements having as their object securities; and
- Proxy solicitations.

The Bank of Italy and the National Commission for Companies and the Stock Exchange have the power to issue rulings, having as their object the interpretation and the enforcement of the securities regulations, in response to queries submitted by banks, investment firms, associations of intermediaries, such as the Italian Association of Asset Managers (*Assogestioni*), or by law firms. Even though the addressees of these rulings are the relevant applicants, such rulings provide guidance in relation to similar operations to be undertaken by all the other players.

Further to the implementation in Italy of the AIFMD, the above-mentioned second-level rules must be amended. In this context, the Bank of Italy and the National Commission for Companies and the Stock Exchange have launched a consultation procedure that ended on 26 August 2014 in order to amend the second-level regulations that will be affected by the implementation of the AIFMD.

Authorities

As mentioned, the Bank of Italy and the National Commission for Companies and the Stock Exchange have, within their respective competences, the power to issue regulations for the implementation of the Consolidated Text.

The competences of the Bank of Italy and the National Commission for Companies and the Stock Exchange are described by the Consolidated Text. As a general rule, the Bank of Italy is competent for those aspects concerning the reduction of the investment risks and the asset stability of the entities which provide investment services; the National Commission for Companies and the Stock Exchange is competent for ensuring the correctness and the transparency of the actions of such entities.

Following the implementation of MiFID in Italy, and in particular the circumstance that in the system of MiFID the supervision by the regulators should be oriented towards 'objectives', the Consolidated Text, as revised, provides that the supervision activity of the Bank of Italy and the National Commission for Companies and the Stock Exchange, each within the competences described in the preceding paragraph, have the following objectives:

- Confidence in the financial system;
- Protection of investors;
- Stability and the satisfactory operations of the Italian financial system;
- Competitiveness of the financial system; and
- Compliance with the rules governing financial matters.

The general principles to be followed by the Bank of Italy and the National Commission for Companies and the Stock Exchange in issuing rules for the implementation of the Consolidated Text (see text, below) and in their supervisory activity are also a consequence of the implementation of MiFID in the Italian legal system; these principles include:

- A relatively high degree of independence from regulatory constraints in the decisions of the intermediaries;
- The proportionality between a given regulatory action and the 'sacrifice' required for the intermediary to reach the objective of such regulatory action, in the sense that such 'sacrifice' should be the minimum possible;

- The recognition of the internationality of the financial markets and safeguard of the competitiveness of the Italian financial industry; and
- The facilitation of the innovation and competition.

On the basis of such general criteria, the regulations issued or to be issued by the Bank of Italy focus on:

- The capital adequacy of the intermediaries;
- The custody of assets held by intermediaries;
- The investment restrictions applicable to Italian investment funds and SICAVs;
- The rules for fractioning and reduction of risk; and
- The criteria for calculation of the value of assets of intermediaries.

With regard to the regulations issued, or to be issued, by the National Commission for Companies and the Stock Exchange, they focus on transparency, including information to investors in rendering investment services and in managing collective investment schemes, requirements for advertisements and research concerning financial instruments/services, and reporting to clients, and correctness, including know-your-customer procedures in view of the assessment of suitability/appropriateness of the investment service for the relevant client, as required by MiFID, best execution, execution of orders, consistency of the management activity with the relevant investment objective, and inducements.

Changes introduced by Decree Number 47 to the Consolidated Text in connection with the implementation of UCITS IV have eliminated the supervisory powers of the Bank of Italy in connection with the marketing in Italy of foreign UCITS. Accordingly, the Bank of Italy is no longer involved in the new passporting procedure under UCITS IV so long as the 'Notification' (see text, below) is served by the home country regulator only to National Commission for Companies and the Stock Exchange; otherwise, the competence of the Bank of Italy in connection with the authorization of foreign non-UCITS not covered by the AIFMD (for the lack of a complete correspondence between the definitions of non-UCITs and Alternative Investment Fund subject to the AIFMD please see below) remained unchanged.

In addition to the above matters, for which either regulator is competent on an exclusive basis, the Consolidated Text specifies a series of matters governed by regulations to be issued jointly by the Bank of Italy and the National Commission for Companies and the Stock Exchange. These matters include, with regard to investment firms, fund management companies, and investment companies, internal organization, continuance of the activity accounting, compliance, internal control, audit, record-keeping complaints of clients, personal transactions of employees and directors, outsourcing and delegation

of management, conflict of interest, and procedures for checking the compliance with the applicable regulations of the payment and receipt of inducements.

According to the Consolidated Text, Italian regulators must cooperate with the correspondent regulators of the other member states of the EU. In particular, information received by the Bank of Italy or the National Commission for Companies and the Stock Exchange cannot be forwarded to other regulatory authorities without the prior consent of the regulator which sent such information to the Bank of Italy or the National Commission for Companies and the Stock Exchange.

On the domestic market, the Bank of Italy and the National Commission for Companies and the Stock Exchange must coordinate their activities to reduce the duties of the entities which provide investment services. With regard to this issue, the Bank of Italy and the National Commission for Companies and the Stock Exchange issued a Protocol in October 2007 which, based on the respective competence as shown above, clarified the duties to be actually carried out by each regulator in the regulatory and supervisory activity, as well as the exchange of information, also with regard to the irregularities found by either the Bank of Italy or the National Commission for Companies and the Stock Exchange.

Definitions

The definitions given by the Consolidated Text are, in general, consistent with those given by the correspondent EU rules, in particular, MiFID and AIFMD. Moreover, additional definitions have been included, such as 'collective savings management' (see text, below) and those relating to various types of investment funds which can be established or marketed in Italy.

In this context, Law Number 122 of 30 July 2010, amending the Consolidated Text, has set out a new definition of 'common investment fund', ie, 'equity raised independently through the issue of one or more fund units from among a number of investors, with the aim of investing the equity raised in accordance with a pre-established investment policy; divided into units pertaining to a given number of investors; managed upstream in the interests of the investors and fully independent of those investors'.

The purpose of such definition is to introduce, different from the past, the principle of aim of the equity on the basis of a predetermined policy and the concept of management carried out in the interests of the investors and in full independence of those investors. In addition, Law Number 122 of 30 July 2010 has specified that 'commitments relating to bonds subscribed on its own account shall be met solely from the investment fund's own equity'. Following the implementation of the AIFMD, new or amended definitions have been introduced in the Italian legal system by Decree Number 44 in article 1 of the Consolidated Text.

One of the most important changes is related to the definition of 'management on a collective basis' (article 1, paragraph 1, letter n) of the Consolidated Text), which is now defined as the service which is carried out through the management of collective investment schemes and of the relevant risks. Therefore, in accordance with the AIFMD, the new definition of 'collective management' has overcome the duplication in the previous definition, which instead distinguished between the promotion and administration of a fund (the company carrying out this activity was called 'promoter SGR) and the actual management of the investments of the relevant collective investment scheme (the company carrying out this activity was called 'manager SGR'). The new definition considers as 'collective management' only the 'core' activities of the management of the fund and the risk management.

Decree Number 44 also provides a new definition of investment company with variable capital (article 1, paragraph 1, letter i), which is defined as '[. . .] the collective investment scheme established in the form of open ended investment company and with registered office and head office in Italy of which the sole purpose is the investment collective of funds raised through the offering of its share'.

Together with the new definition of SICAV, Decree 44 has introduced a new investment vehicle, the SICAF, which, according to article 1, paragraph 1, letter I *bis* of the Consolidated text, is a: '[. . .] closed-ended collective investment scheme incorporated as a joint stock company with fixed capital, with its registered office and head office in Italy which sole object is the collective investment of funds raised through the offering of its shares and other equity instruments'.

Moreover, Decree Number 44 has amended the definitions of 'investment fund' and of 'collective investment scheme', where the characteristics that the Consolidated Text previously ascribed only to the 'investment funds' of the 'contractual type' have been extended to the series of the collective investment schemes.

In particular, 'collective investment scheme' under the new article 1, paragraph 1, letter k, of the Consolidated Text is 'a scheme established for the provision of service of collective asset management, the assets of which have been collected from a plurality of investors and fully independent form those investors and invested in financial instruments, loans, investments, or other movable or immovable properties, according to pre-determined investment policies'.

Furthermore, other definitions have been introduced by Decree Number 44 in article 1, paragraph 1, of the Consolidated Text in connection with the new vehicles managed by entities subject to the AIFMD. Finally, letter o *bis*) of article 1, paragraph 1, introduces a new definition of EU UCITS management company. These companies were previously defined as 'harmonized management companies', but the fact that also the AIFMs are 'harmonized' (so long as they comply with a Directive) would have rendered inaccurate a definition of 'harmonized' limited to UCITS management companies.

Entities Qualified to Render Investment Services

In General

The Consolidated Text confirms the provisions of the MiFID governing the ability of an entity to provide investment services in Italy. In particular, the investment services and activities contemplated by the Consolidated Text are those detailed in the MiFID. These services and activities are the following:

- Dealing on own account;
- Execution of orders on behalf of clients;
- Underwriting and/or placing on a firm commitment basis;
- Placing without a firm commitment basis;
- Portfolio management;
- Reception and transmission of orders;
- Advice on investments; and
- Operation of multilateral trading facilities.

'Advice on investments' was added to the investment services following the implementation of MiFID. In particular, such investment service, which is now a regulated activity, consists of 'the provision of personalized recommendations to a client, on its request or on initiative of the intermediary, with regard to one or more transactions connected with a certain financial instrument. The recommendation is personalized when it is submitted as suitable to the client or takes into account the characteristics of the client. A recommendation is not personalized if it is divulged to the public by means of distribution channels'.

The ability to render investment services also qualifies for the rendering of relevant 'non-core' services provided for in the MiFID. According to the Consolidated Text, investment services can be rendered in Italy by investment firms (*imprese di investimento*) and banks. Furthermore, portfolio management, as well as the placing of third-party collective investment schemes, can be rendered by companies authorized to engage in the activity of 'collective savings management' (see text, below).

With regard to the definition and the categorization of the service providers, a regulation issued by the National Commission for Companies and the Stock Exchange defines 'intermediaries' or 'authorized intermediaries' as the entities carrying out investment services or activities which must comply with the rules of MiFID as transposed in Italy; accordingly, the legal status of the 'intermediaries' or 'authorized intermediaries' in the Italian legal system correspond to one of the 'investment firms' under MiFID. Under the regulation of the National Commission for Companies and the Stock Exchange, the following entities are 'intermediaries' (also known as 'authorized intermediaries):

- Italian SIMs (ie, Italian securities brokerage firms introduced by a statute of 1991, repealed by the Consolidated Text);[10]
- Italian banks authorized to carry out investment services and activities;
- Stockbrokers (*Agenti di Cambio*);
- Certain local financial intermediaries enrolled in a register kept by the Bank of Italy, which are authorized to carry out investment services;
- Italian fund management companies (SGRs) or fund management companies of other EU countries authorized to carry out portfolio management ('harmonized' management companies);
- The division of Poste Italiane SpA competent for the investment services and activities;
- EU investment firms and banks with branches in Italy; and
- Other EU or non-EU entities authorized to carry out investment services or activities in Italy.

With regard to the investment services rendered by non-Italian investment firms, there is a difference based on the place of incorporation of the relevant company. In particular, EU companies need not have an 'authorization' in Italy on the basis of the principle of mutual recognition of entities already authorized in another EU member state pursuant to EU regulations having as their object the harmonization of certain products or services.

Therefore, investment firms established in other EU member states can render Investment Services (which the Consolidated Text defines for this purpose as 'services liable to mutual recognition' by reference to the MiFID) in Italy, either from their home country or through a branch in Italy, on notice to the National Commission for Companies and the Stock Exchange from the supervisory authorities of the respective country of origin; the branches of EU investment firms can start their activities two months after such notice.

Services which require an authorization from the Italian authorities are financial services rendered by EU investment firms that do not fall within the scope of application of the MiFID and the services to be rendered by non-EU investment firms.

In particular, EU investment firms can be authorized by the National Commission for Companies and the Stock Exchange to render other types of financial services not included in the list of the services liable to mutual recognition of the MiFID.

To obtain such authorization, the EU investment firm must file with the National Commission for Companies and the Stock Exchange an application

10 SIMs are an Italian type of company equivalent to the investment firms set out by MiFID.

accompanied by the documentation prescribed by the National Commission for Companies and the Stock Exchange. The National Commission for Companies and the Stock Exchange will decide on the authorization within 120 days from filing; failure to render a decision within 120 days will be taken as authorization.

Non-EU investment firms can render investment services in Italy either on a crossborder basis or through the establishment of branches, which must be authorized by the National Commission for Companies and the Stock Exchange.

For this purpose, a non-EU investment firm must file with the National Commission for Companies and the Stock Exchange an application accompanied by the documentation prescribed by the National Commission for Companies and the Stock Exchange. The application will be examined by the National Commission for Companies and the Stock Exchange only if the following circumstances obtain:

- The Italian branch complies with certain requirements provided for by the Consolidated Text for the Italian securities brokerage companies;[11]
- The applicant is actually authorized in its non-EU home country to render those investment services for which it is applying in Italy;
- The rules of the home country of the applicant governing the investment firms are equivalent to the Italian rules on securities brokerage companies with regard to the authorizations, the organization, and the supervision by the regulators;
- Mutual assistance agreements are in force between the Bank of Italy and/or the National Commission for Companies and the Stock Exchange, on one side, and the regulators of the home country of the applicant, on the other side;[12] and
- The foreign home country applies the principle of reciprocity *vis-à-vis* Italian companies.

The National Commission for Companies and the Stock Exchange will decide on the authorization within 120 days from the filing; failure to render a decision within 120 days will be taken as authorization.

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11 These requirements are that the stock capital of the applicant be above the thresholds determined by the Bank of Italy, that information be provided on the organization of the applicant and on its initial activities in Italy, and that the directors and the managers of the applicant do not have certain types of criminal records.

12 The National Commission for Companies and the Stock Exchange has stipulated such agreements with regulators for Albania, Argentina, Australia, Belgium, Brazil, Canada, China (PR), Czech Republic, Egypt, France, Germany, Guernsey, Hong Kong, Hungary, Jersey, Malaysia, Poland, Portugal, Principate of Monaco, Republic of Moldova, Romania, San Marino, Singapore, Republic of Slovakia, Slovenia, South Africa, Spain, Taiwan, Turkey, United Kingdom, and United States.

Provisions on Rendering of Investment Services

In General

The Consolidated Text provides for rules on the rendering of some investment services, as well as general rules which apply to all investment services. These general rules include the separation of the sums entrusted by the client from the other assets held by the intermediary, and the general obligation to enter into written agreements in relation to the rendering of investment services, except the advice on investments, for which the written agreement is not mandatory.

As noted, the rules on the rendering of investment services in the Consolidated Text and in the regulations issued by the Bank of Italy and the National Commission for Companies and the Stock Exchange have been materially affected in connection with the implementation of MiFID and the Level 2 Directive. The Consolidated Text provides for general principles of conduct, according to which the intermediaries are required to:

- Act with diligence, correctness, and transparency to serve clients' interest;
- Acquire from the clients such information which are necessary for the purpose of rendering the Investment Services and assure that clients are always informed;
- Use in any advertisement or promotional message information which is correct, clear, and not misleading; have procedures, including those of internal control, liable to assure that the activity of the intermediary is carried out in an efficient manner; have procedures for the identification and the limitation of the cases of conflict of interest and to assure such conflicts of interest do not adversely affect the interest of the clients; and
- Where applicable, carry out the asset management activity in a safe and independent fashion and establish procedures for the protection of the clients' interest on the assets under management.

With regard to the investment services at a more specific level, the regulatory framework is based on the distinction between those investment services, ie, portfolio management and advice on investments, with a higher added value and which require a higher level of protection for the client, other investment services such as placing of securities, which require a normal level of protection for the client, and services consisting (entirely or partly) of the mere execution of the orders of the client (execution only services), for which the protection is progressively lowered.

Such different levels of protection for the client are reflected in the information on the client that the intermediary must gather before rendering the investment services (see text, above), so that, in the case of the services with higher protection, ie, portfolio management and advice on investments, the intermediary will be able to recommend the most 'suitable' service while, for the other investment services (other than the 'execution only' services), the intermediary shall be able to recommend the most 'appropriate' services.

In this context, the main difference between the determination of the 'suitability' (*adeguatezza*) and of the 'appropriateness' (*appropriatezza*) of an investment service for a client is that in the test of suitability the intermediary must determine the profile of the client — inclusive of its financial standing and investment objectives — and the client's knowledge and experience in the investment field relevant to the specific type of product or service, while in the test of appropriateness the intermediary has only to verify the client's knowledge of the relevant type of product or service.

Another difference is that failing a complete test of suitability, the investment services cannot be rendered by the intermediary, while in case of incomplete test of appropriateness, the investment service can be rendered, but the client should be informed of the potential adverse effects of such incomplete test. Furthermore, the applicable Italian rules exempt the intermediary from the assessment of suitability or appropriateness in connection with the investment services of reception and transmission of orders and execution of orders on behalf of clients (execution only services).

For the purpose of their protection, clients are divided in categories, according to the fact that they require the investment services in carrying out a professional activity or not; in addition, there is a further category (the 'eligible counterparties') which is determined on the basis of the investment service received by the client. To these three categories of clients correspond a difference in terms of applicable rules and, in particular, for the retail clients the regulation on intermediaries issued by the National Commission for Companies and the Stock Exchange provides for a higher level of protection than for the professional clients and the eligible counterparty.

Licensing Requirements for Italian Fund Management Companies Managing UCITS and/or AIFs, Delegation and Depositary

In General

With reference to Italian fund management companies (ie, 'SGR'), no new definition has been introduced by Decree 44, however, articles 34 and 35 of the Consolidated Text provide that SGRs must be authorized by the Bank of Italy, after consulting the National Commission for Companies and the Stock Exchange, '[. . .] in order to carry out asset management activities with respect to both the AIF and to the UCITS'. This means that the same SGR can be authorized for both UCITS and AIFs, although the two authorizations remain separated.

Italian SGRs continue to be authorized by the Bank of Italy. With reference to the thresholds, the Italian legislator has implemented the relevant provisions of the AIFMD. In particular, article 35 *undecies* of the Consolidated Text provides that with reference to Italian AIFMs, the Bank of Italy and National Commission for Companies and the Stock Exchange, within their respective competences, may exempt licensed operators managing Italian Reserved AIFs,

of which the total AUM do not exceed €100 million or €500 million if the managed collective investment schemes are not leveraged and do not allow investors to exercise the reimbursement right for five years after the initial investment, from the provisions implementing article 6, paragraphs 1, 2, and 2 *bis* of the Consolidated Text (ie, supervisory functions of the Bank of Italy and National Commission for Companies and the Stock Exchange). These are the so-called 'below-threshold' managers.

Before the AIFMD, Italian SGRs were authorized to carry out in addition to the collective management the investment services of management on a discretionary basis, advice on investments and placing, but not the reception and the transmission of orders; in compliance with the AIFMD, the Consolidated Text now provides that SGRs managing AIFs (but not those managing UCITS) can carry out the reception and the transmission of orders, in addition to the above-mentioned investment services.

As mentioned, the previous Italian model that contemplated a separation between the promotion and the management of CIS has been overcome as set forth by article 5, paragraph 1, of the AIMD Directive, which provides that 'each AIF managed within the scope of this Directive shall have a single AIFM, responsible for the 5 compliance with this Directive'. Article 4, paragraph 1, letter b, of the AIFM Directive defines the AIFM as 'Legal persons regularly engaged in the business of managing one or more AIFs'. Therefore, the new definition of collective management set out in article 1, paragraph 1, letter n, of the Consolidated Text is 'the service that is performed through the management of collective investment schemes and of the relevant risks'.

Retail Clients

Retail clients are the category of the normal individual clients. They are determined on a residual basis, in the sense that an entity/person who is neither a professional client nor an eligible counterparty is a retail client.

Professional Clients

Professional clients are those who have the necessary experience, knowledge, and expertise to take their decision with awareness with regard to investments and who, therefore, are able to assess correctly the risks they take. Professional clients are described in MiFID, and the description made by the Italian rules is consistent thereto.

There are either professional clients per se and professional clients on request, in the sense that a person who under normal conditions would be a retail client can ask the intermediary to be treated as a professional client through a procedure that requires that the intermediary expressly discloses to the applicant the higher risks related to being treated as a professional client; the reverse also is possible,

and a professional client will be able to ask the intermediary to be treated as a retail client, but the intermediary will not be bound to allow such treatment.

Eligible Counterparties

Eligible counterparties are clients who receive from the intermediary the services of execution of orders and/or dealing on own account and/or receipt and transmission of orders. The rendering of investment services by an investment firm to a client must be governed by a written agreement; such requirement does not apply to advice on investments.

Agreements Concerning Investment Services

Italian regulations provide for the minimum contents of the agreements, which include the determination on the relevant investment service and financial instruments to be used, reporting to the client and procedures to allow the transmission of instructions from the latter to the intermediary, and inducements, if any, received by the intermediary in connection with the services/financial products which are the object of the agreement. When the relevant investment service is the portfolio management, the agreement also must specify the financial instruments to be used in the client's portfolio, the level of risk, the leverage, if any, the benchmark, and whether the management can be delegated to third parties.

The National Commission for Companies and the Stock Exchange have clarified that such delegation can be delegated not only to EU-authorized companies, but also to non-EU companies authorized to carry out management of investment portfolios in their home country, established in non-EU countries with whom the National Commission for Companies and the Stock Exchange has stipulated agreements of mutual co-operation. In many cases, Italian asset managers do not actively manage the investment portfolios committed by their clients, but only insert into such portfolios investment funds or SICAVs managed by third parties, thus carrying out a *de facto* delegation in favor of the manager of the fund utilized in the investment portfolio.

With regard to the offer (placing) of securities outside the premises of the offeror or placing agent, the Consolidated Text confirms the previous rules thereon, according to which such type of placement can be effected only through 'financial promoters', ie, persons having passed an examination administered by the National Commission for Companies and the Stock Exchange and enrolled in a register kept by the National Commission for Companies and the Stock Exchange. Pursuant to National Commission for Companies and the Stock Exchange Resolution Number 17581 of 3 December 2010, financial promoters must act with diligence, correctness, and transparency, by respecting laws and regulations pertaining to their activity as well as laws, regulations, and procedures relating to the authorized entity which confer them the mandate.

Decree Number 184 introduced in the Consolidated Text the description of those activities which have not to be considered an offer of securities outside the

premises of the offeror or placing agent (for the purpose of the enforcement of the seven-day right of withdrawal). In particular, pursuant to article 30, paragraph 2, of the Consolidated Text, the following two activities need not be considered offers outside the premises:

- An offer to professional clients; and
- An offer of the issuer's own financial instruments addressed to the members of the board of directors, of the supervisory board, to employees and agents who are not employees of the issuer, of the holding company, or if its subsidiaries, made in the respective offices or branches.

In relation to this type of placement, the Consolidated Text also provides for a seven-day right of withdrawal in favor of the investor who has entered into an agreement having as its object the purchase of securities outside the premises of the offeror or distributor. The rule does not apply to public offers of certain types of securities. The Consolidated Text also provides for rules on the promotion and the placement 'at distance' of investment services or financial products. This expression means that the offeror and the addressee of the promotion or of the offer are not physically in the same place; the National Commission for Companies and the Stock Exchange has issued regulations to govern these activities.

Marketing of UCITS and AIFs

UCITS. In relation to the UCITS, the principle of mutual recognition will apply. In particular, an EU member state, defined as 'host country', must 'recognize' the authorization granted by another EU member state, defined 'home country', in compliance with EU rules, such as an authorization to establish an investment fund based on national provisions implementing the UCITS Directive.

Therefore, a foreign UCITS need not be 'authorized' in Italy, but only 'passported' for marketing. Through Resolution Number 18210 of 9 May 2012, the National Commission for Companies and the Stock Exchange has issued second-level provisions having as their purpose the transposition of the rules of UCITS IV concerning the passporting of foreign UCITS in Italy. In particular, Regulation Number 18210 amended National Commission for Companies and the Stock Exchange Regulation Number 11971 of 14 May 1999 on Issuers of Financial Instruments, in order to implement the new rules of the Consolidated Text.

After the implementation of UCITS IV, foreign UCITS can be offered in Italy after completion of the regulator-to-regulator notification procedure. The Italian competent regulator for receiving the notification from the home country regulator is the National Commission for Companies and the Stock Exchange.

Article 19 *bis* of Regulation Number 11917 introduces requirements for the drafting of the Notification Letter. Such notification must be drafted according to Commission Regulation Number 584/2010 (and accompanied by the

documents specified therein, including the UCITS certificate). The National Commission for Companies and the Stock Exchange requires that the Notification must expressly specify whether the offering in Italy also must be addressed to retail investors (thus involving additional requirements such as the Italian Application Form, and the appointment of the paying agent, of the entity in charge of the relationship with the investors and of the placement agent), or if the offer will be addressed exclusively to 'qualified investors' as defined by article 34 *ter*, paragraph 1, letter b, of Regulation Number 11917, with less requirements.

UCITS IV has replaced the Simplified Prospectus with the Key Investors Information Documents (the 'KIID'). In this context, article 98 *ter* of the Consolidated Text expressly states that the KIID and the prospectus are 'pre-contractual' documents. This means that their drafting must comply with those principles of good faith that under the Civil Code must drive the parties in the negotiation of an agreement. In addition, the new rules of the Consolidated Text on the subject matter, introduced by the Decree, provide that 'nobody' can be held liable 'exclusively' for the contents of the KIID, either in the original language or its Italian translation, unless these contents are misleading, inaccurate, or not consistent with the correspondent parts of the prospectus.

With regard to the KIIDs of foreign UCITS, the Consolidated Text provides that they can be 'published', ie, deposited with the Prospectuses Archives of the National Commission for Companies and the Stock Exchange on the business day preceding that of circulation in Italy, only after completion of the regulator-to-regulator notification procedure. This provision is applicable to the KIIDs of share classes/sub-funds addressed to Italian retail investors and, together with the KIIDs addressed to retail investors, also the relevant bespoke application form for use in Italy must be deposited with the Prospectuses Archives of the National Commission for Companies and the Stock Exchange.

Article 19 *bis* of Regulation Number 11971 also states that the only document to be translated in Italian is the KIID, while the other documents can be translated in Italian or left, at UCITS' option, in a language customary in the sphere of international finance, which, in the case of Italy, is English.

Furthermore, article 19 *bis* of Regulation Number 11917 provides that the units or shares must be capable of being sold in Italy after the home country regulator has communicated to the fund that the Notification letter has been transmitted to the National Commission for Companies and the Stock Exchange, it being understood that in case of offering to retail investors, the final deposit with the Prospectuses' Archives of the National Commission for Companies and the Stock Exchange of the Application Form, the KIID, and the prospectus must be made on the business day preceding that in which the retail offering will commence.

AIFs and Foreign 'Non-Harmonized' Investment Funds. The phrase 'foreign non-harmonized investment fund', as used herein, means any non-Italian

collective investment scheme not organized in compliance with the UCITS Directive. In the pre-AIFMD system, a specific procedure administered by the Bank of Italy was in place for the authorization for 'non-harmonized' funds to be marketed in Italy. After the implementation of the AIFMD, the Italian legal system only considers UCITS and AIFs. Therefore, there is not, for the time being, the possibility of authorizing collective investment schemes which are neither UCITS nor AIFs covered by the AIFMD, such as, for example, vehicles managed by a company under the AUM thresholds provided for by the AIFMD (see text, above) or AIFs of non-EU managers not yet authorized in Italy or another EU member state.

Hedge Funds and AIFs. As regards hedge funds, the main second-level regulation is Ministry of Treasury Decree Number 228 of 24 May 1999, as modified. However, so long as Decree Number 228 does not consider AIFs, it will be replaced in the next few months by a new Decree of the Ministry of Economy and Finance, implementing article 39 of the Consolidated Text concerning the determination of the general criteria with which the Italian CIS must comply.

In particular, under article 39 of the Consolidated Text, the Ministry of Economy and Finance must issue a decree in order to determine the types and structures of Italian CIS in relation, to the object of the investment, the categories of investors at whom the offer of units and shares are aimed, the open or closed form, and the duration and the methods of transfer of the assets, where applicable. In relation to the Decree, the Ministry of Economy and Finance launched a consultation procedure that was concluded on 10 June 2014. Subject to what the Ministry of Economy and Finance will decide according to the outcome of the consultation procedure, which did not raise comments on the substantial structure of the forthcoming decree, the latter should provide the following types of Italian CIS:

- Harmonized collective investment schemes, ie, UCITS;
- Italian open-ended AIFs (non-harmonized CIS that may invest up to 20 per cent in unlisted financial instruments);
- Italian closed-end AIFs (form needed to invest in real estate, loans, and other assets for which there is a market and their value can be measured at least every six months);
- Italian real estate AIFs (ie, Italian close-end AIFs investing at least two-thirds of the assets (reduced to 51 per cent in some cases) in real estate property; and
- Italian reserved AIFs, normally reserved for professional investors and that can be open end or closed end, for which the Italian rules do not provide for the categories of assets in which they must invest, and are therefore subject only to the investment rules laid down by the respective regulations.

The last class corresponds to the 'hedge funds' referred to in the previous Decree 228 (defined 'speculative funds), also in view of the fact that the AIFM

of an Italian reserved AIF can allow investments by retail investors subject to a minimum of €500,000, ie, the same as the speculative funds.

With regard to marketing in Italy, and consistent with the AIFMD, article 43 of the Consolidated Text, as amended, by Decree Number 44 provides that the marketing of AIFs is the offer, even indirectly, by initiative or on behalf of the AIFM, of the units or shares of the managed AIF addressed to investors resident or having their registered office in the EU. The marketing to professional investors in Italy of the units or shares of reserved Italian AIFs, EU AIFs, and non-EU AIFs managed by an SGR or by a non-EU AIFM authorized in Italy, and the marketing to professional investors in an EU member state other than Italy, of the units or shares of Italian AIFs, EU AIFs, and non-EU AIFs managed by an SGR or a non-EU AIFM authorized in Italy, are preceded by a notification to the National Commission for Companies and the Stock Exchange. The National Commission for Companies and the Stock Exchange must promptly provide to the Bank of Italy all the information provided in the notification and the documents attached to it.

Otherwise, the marketing of units or shares of AIFs on the initiative of the investor (the so-called 'passive marketing') does not fall within the scope of the AIFM Directive. In this context, there are no 'private placement' rules in Italy, in the sense that authorization is required even where the offer in Italy is addressed exclusively to professional investors. Under National Commission for Companies and the Stock Exchange guidance, 'offering in Italy' means 'taking the initiative' to contact prospective investors situated in Italy. As a consequence, a foreign fund is not considered to be 'offered' in Italy if it is sold as the result of unsolicited requests from Italian investors.

In particular, a foreign fund (including a hedge fund) which is not authorized to market its units in Italy, which has not been passported in Italy, ie, which has not obtained the relevant Bank of Italy and National Commission for Companies and the Stock Exchange approvals, may sell its units or shares to Italian investors provided the first investment request is initiated by the Italian investor contacting the foreign fund outside Italian territory to buy its units. When this condition is met (and, for the fund's protection, capable of being adequately evidenced, such as through a written request for information submitted by the Italian investor), the sale is considered to be foreign and not Italian, because it occurs on an unsolicited basis.

On the other hand, an 'offer' is deemed to take place in Italy, with the consequent requirement for authorization, if the first initiative to offer the units to Italian investors is taken by the foreign issuer or offeror. The other rules of the Consolidated Text for the offering of foreign AIFs in Italy are also consistent with those set out in the AIFMD, and shall be actually implemented through specific regulations of the Bank of Italy and the National Commission for Companies and the Stock Exchange. It should be noted that Italy also will allow the offering of AIFs to retail investors, albeit the authorization procedure will be more complex.

Exchange Traded Funds. Another class of funds has been admitted in the Italian regulated market. The company managing the Italian regulated markets issued a Resolution on 6 September 2001, approved by the National Commission for Companies and the Stock Exchange, concerning the introduction of a segment of negotiation known as the *Mercato Telematico dei Fondi* (MTF). This segment allows the negotiation of Exchange Traded Funds (ETF).

The MTF was replaced, in March 2007, by a new market segment, ETFplus, where not only ETF are listed, but also another type of security, called 'Exchange Traded Commodities' (ETC). As a consequence, the National Commission for Companies and the Stock Exchange has modified Regulation Number 11971 in order to allow registration in Italy of foreign UCITS organized as ETF. From September 2014, actively managed ETFs started the trades on the ETFplus market; from October 2014, also collective investment schemes not qualifying as ETFs shall be capable of being traded on the ETFplus market at the NAV instead of the market price (applicable to ETFs).

Powers of Regulators as to Intermediaries

In General

In case of violations of the rules of the Consolidated Text, the Bank of Italy, and the National Commission for Companies and the Stock Exchange, each, according to its competence as described above, are empowered to order the relevant intermediary to discontinue such violation. The term 'intermediaries' means Italian securities brokerage companies and securities management firms, as well as SICAVs and Italian branches of foreign investment firms or banks.

With regard to violations imputable to Italian or non-EU intermediaries, the competent Italian authority may prohibit commencement of new operations related to one or more investment services, as well as order the closing of one or more branches, when the violation may adversely affect the general interest of the economy or, in case of urgency, to protect the interests of investors. The same measures can be adopted *vis-à-vis* EU intermediaries and, in this case, the Italian authority will address a copy of the relevant order to the supervisory authority of the country of origin of the intermediary.

Furthermore, the Bank of Italy or the National Commission for Companies and the Stock Exchange also may order the interruption of the activity in Italy of EU intermediaries or the closing of one or more branches in case of violation of the Italian rules on investment services if, notwithstanding the notice of such violation given by the Italian regulators to those of the country of origin of the relevant EU investment firm, such entity continues the action in breach of the Italian rules.

In case of danger for investors or for the markets, the President of the National Commission for Companies and the Stock Exchange can order suspension of the

functions of the boards of directors of Italian securities brokerage companies, securities management firms, or SICAVs, or of the managing boards of Italian branches of non-EU investment companies, and appoint a commissioner who will replace the above boards.

Finally, the Bank of Italy or the National Commission for Companies and the Stock Exchange may order suspension of the marketing in Italy of foreign UCITS or collective investment schemes for a maximum period of 60 days in case of alleged violation of the rules of the Consolidated Text on UCITS and collective investment schemes. Such marketing also may be prohibited should the violations be finally ascertained.

Discipline of Intermediaries

The Consolidated Text provides for two main procedures, ie, 'extraordinary administration' (*Amministrazione Straordinaria*) and 'compulsory administrative dissolution' (*Liquidazione Coatta Amministrativa*).

Extraordinary administration can be ordered by the Minister of Economy and Finance in case of material irregularities in the management of the concerned company or in case of serious losses suffered by the company. The starting of this procedure also may be requested by the board of directors or by the extraordinary shareholders' meeting of the company, or by the commissioner above described. The same procedure also is applicable to the Italian branches of non-EU investment companies.

Compulsory administrative dissolution, which is preceded by the revocation of the authorization to provide investment services, can be ordered by the Minister of Economy and Finance in case of 'exceptionally serious' violations of the rules of the Consolidated Text or irregularities in the management of the concerned company. This procedure also is applicable to the Italian branches of non-EU investment companies, as well as to the Italian branches of EU investment companies, in case of revocation of the authorization to provide investment services in the home country.

Compensation Schemes

Finally, the Consolidated Text provides that Italian investment firms must participate in compensation schemes which have been established by a Decree of the Minister of Economy and Finance. Italian branches of EU investment firms or banks can participate in compensation schemes recognized in Italy, with regard to the activity carried out in Italy.

Italian branches of non-EU investment firms or banks must participate in compensation schemes recognized in Italy, with regard to the activity carried out in Italy, unless they participate in foreign compensation schemes equivalent to those recognized in Italy and, in such case, the Bank of Italy will verify the adequacy of such compensation schemes.

Regulated and Multilateral Trading Facilities

Regulated Markets

The Consolidated Text provides that the regulated markets of financial instruments must be organized and exercised by joint-stock companies (the 'managing company). According to the Consolidated Text, as amended for the implementation of MiFID, a 'regulated market' is a multilateral system which, in accordance with its non-discretionary rules, brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments admitted to trading under the rules of the market, in a way that results in a contract, and which is managed by a management company and is authorized and functions regularly.

In this regard, article 62, paragraph 1, of the Consolidated Text, as amended by Decree Number 184, provides that the organization and management of a market shall be governed by rules approved by the ordinary shareholders' meeting or the supervisory board or, if appropriate, by the management body of the stock exchange. Moreover, the Consolidated Text provides general rules on managing companies, as well as on the holding of interest in such companies. The managing of the regulated markets is authorized by the National Commission for Companies and the Stock Exchange.

By means of a Resolution of December 1997, the National Commission for Companies and the Stock Exchange authorized Borsa Italiana SpA, a company established for this purpose, to act as managing company of the Italian Stock Exchange. The managing company has issued a series of regulations governing the organization of the Italian Stock Exchange. These regulations cover the following items:

- Formalities for the admission to the listing and cases of suspension and exclusion from the listing;
- Formalities for the transactions on the Italian Stock Exchange and duties of the traders and of the issuers;
- Formalities for the determination, publishing, and circulation of the prices; and
- Types of contracts admitted to the listing and minimum orders thereof.

Once authorized, the regulated markets are included in a list which is maintained and updated by the National Commission for Companies and the Stock Exchange. Such list includes Italian regulated markets and foreign regulated markets recognized by the National Commission for Companies and the Stock Exchange. As a consequence of the implementation of MiFID, the distinction between 'regulated' and 'unregulated' markets provided for by Italian law until October 2007 is no longer effective. This is because the Consolidated Text implemented the provisions of MiFID on the abrogation of the obligation to concentrate the trades on regulated markets; the trading of

listed securities is no longer carried out exclusively on regulated markets, but also on 'multilateral trading facilities' and/or is carried out by 'systematic internalizers'.

According to the Consolidated Text, a 'multilateral trading facility' is a multilateral system, operated by an investment firm or a market operator which, in accordance with its non-discretionary rules, brings together multiple third-party buying and selling interests in financial instruments in a way that results in a contract. According to the Consolidated Text, a 'systematic internalizer' is an investment firm which, on an organized, frequent, and systematic basis, deals on its own account by executing clients' orders outside a regulated market or an multilateral trading facility.

The Consolidated Text provides that the National Commission for Companies and the Stock Exchange identifies the requirements for the operations of the multilateral trading facilities and systematic internalizers, monitors the regulations and the practices adopted by multilateral trading facilities to satisfy the EU regulations, and establishes the rules of transparency pre- and post-trade for the transactions of securities listed on multilateral trading facilities and/or by systematic internalizers. In particular, the National Commission for Companies and the Stock Exchange sets out the obligations for the management companies of the multilateral trading facilities regarding:

- Dealing and completion of transactions;
- Admission to listing of financial instruments;
- Information for the public and the users;
- Access to the system; and
- Compliance by the users with the rules of the system.

To achieve the objective of transparency, management companies of regulated markets, market managers of multilateral trading facilities, and systematic internalizers have the obligation to disseminate the current prices of purchase and selling and the volume of trade. By means of Regulation Number 16191 of 2007, as amended by Resolution Number 18214 of 9 May 2012, the National Commission for Companies and the Stock Exchange set forth the above obligations of notification of the operations and the rules of transparency for the multilateral trading facilities and systematic internalizers.

Centralized Administration of Financial Instruments

The Consolidated Text provides that the centralized administration of financial instruments must be effected by duly authorized companies having such activity as their sole purpose. These companies are under the supervision of the National Commission for Companies and the Stock Exchange and of the Bank of Italy. Presently, the centralized administration of financial instruments is carried out by Monte Titoli SpA.

The regulation and terms of agreement for the services of Monte Titoli (the 'Regulation) have been approved by the National Commission for Companies and the Stock Exchange in 1997, as lately amended in 2010. The Regulation governs:

- The type and characteristics of the financial instruments which can be inserted in the system of Monte Titoli; and
- The formalities for the use of the services of Monte Titoli by depositaries or issuers of securities, including the reference to specific agreements to be used for that purpose.

Moreover, the Regulation disciplines the deposit and the transfer of financial instruments administered by Monte Titoli, as well as the clearing-house and liquidation services of Monte Titoli. The Regulation also provides an appendix with the fees for the services of Monte Titoli. The latest amendments to the Regulation approved in 2010 by the National Commission for Companies and the Stock Exchange aim at rendering more efficient the administration of the paid increase of capital transactions of companies having stocks centralized with Monte Titoli SpA.

Short Selling

In connection with the Short Selling Regulation, Decree Number 179 has introduced in the Consolidated Text some important rules on the identification of the national Authorities with competence on short selling and certain aspects of derivative contracts for hedging the credit default swap risk.

In particular, the Ministry of Economy and Finance, the Bank of Italy, and the National Commission for Companies and Stock Exchange are the national competent authorities pursuant to the Short Selling Regulation. In addition, the National Commission for Companies and Stock Exchange is the authority responsible for coordinating the cooperation and exchange of information with the EU Commission, ESMA, and the competent authorities of the other member states, pursuant to article 32 of the Short Selling Regulation.

Public Offers of Financial Products

In General

As a general rule, any public offer of securities in Italy must be preceded by the issue of a prospectus and by a prior notice to the National Commission for Companies and the Stock Exchange. This notice must be drafted according to an outline provided for in a regulation issued by the National Commission for Companies and the Stock Exchange.

The offer can be launched on approval of the prospectus by the National Commission for Companies and the Stock Exchange, and such approval is

granted by means of the clearance to deposit the prospectus with the National Commission for Companies and the Stock Exchange for the purpose of its publication.

Decree Number 184, in accordance with Directive 2010/73/EC, has introduced rules in the Consolidated Text in order to simplify the procedure for prospectus approval. The timing for approval of the prospectus of securities of Italian issuers by the National Commission for Companies and the Stock Exchange ranges between 10 and 40 days from filing, according to the type of financial instruments which are the object of the offer.

The above terms may be suspended if the National Commission for Companies and the Stock Exchange requires the applicant to provide further information or documents. After the approval of the prospectus, the placement must be started within six months from such approval. Those issuers that have already published a prospectus are allowed, in connection with the promotion of any further public offer launched within 12 months after such publication, to use the same prospectus with the relevant information updated as appropriate by means of a separate note (integrative note), indicating the financial instruments which are the object of the new solicitation and the relevant information.

Filing of Italian Prospectuses

The prospectuses to be filed for the first time in Italy must be drafted according to the outline provided for by EU Regulation 809/2004/EC. If the offering must be carried out only in Italy, the prospectus must be drafted in Italian. In compliance with Directive 2003/71/EC, the Italian prospectuses must include a summary. Through Regulation Number 11971, as amended by Regulation Number 18210, the National Commission for Companies and the Stock Exchange has determined the templates covering the prospectuses for the various financial instruments that can be offered.

The guidelines provided by the National Commission for Companies and the Stock Exchange cover the 'solicitation' accompanied by the listing on security markets. Therefore, in the case of a prospectus related to a 'solicitation' without listing or to a listing without solicitation, the guidelines provided by the National Commission for Companies and the Stock Exchange will be enforced only to the extent their provisions are applicable.

Filing of Foreign Prospectuses

Foreign prospectuses, drafted in compliance with Directive Number 2003/71/EC, as amended by Directive 2010/73/EC, can be freely circulated in Italy, provided the foreign regulator which approved the prospectus transmits to the National Commission for Companies and the Stock Exchange the following documents:

- A certificate noting that the prospectus has been drafted in compliance with Directive Number 2003/71/EC;

- A copy of the prospectus; and
- An Italian translation of the summary.

While the summary must be translated into Italian, the prospectus can be deposited and circulated in Italian or in a language 'commonly used in the world of the international finance', such as English. For the avoidance of doubt, the rules on the recognition of foreign prospectuses do not apply to the prospectuses of a UCITS, for which the registration procedure described in the previous paragraphs will apply.

Private Placements of Financial Products and Prospectus Obligation Exemptions

Situation Prior to Issue of Consolidated Text

The Consolidated Text does not provide for an express definition of private placement, while the public offers are expressly defined. Therefore, this definition should be taken as reference to determine which placements do not fall within the field of application of the rules on public offers and, therefore, can be considered as 'private placements'.

Thus, in the Italian regulatory system, a 'private placement' is an offer of securities for which the issue of a prospectus and/or its approval by the National Commission for Companies and the Stock Exchange is not required. The list of exemptions from prospectus requirements was established in a regulation issued by the National Commission for Companies and the Stock Exchange on the basis of the regulatory powers granted by Law Number 216/74. The relevant placements were the following:

- Offers of securities addressed only to 'professional investors', such term defining, among other entities, banks, insurance companies, securities brokerage companies, fiduciary companies carrying out asset management services, certain financial companies, closed-end investment funds, pension funds, and investment funds;
- Auction sales of securities effected pursuant to judicial or administrative proceedings;
- Offers of the entire capital, or of a controlling interest in, a company, addressed to one person only;
- Setting up of a company with the invitation to the public to subscribe for shares in such company pursuant to articles 2333 *et seq* of the Civil Code;
- Offers of securities addressed to the managers of the issuer, or of the companies controlled by, or controlling, the issuer;
- Offers of securities addressed to the employees of the issuer, individually determined, provided that the number of securities offered to each employee had been previously determined and the same securities could not be assigned to another employee; and

- Offers of shares of companies managing sport teams.

Any other placement of financial instruments required the issue of a prospectus. Therefore, certain exemptions recognized in other jurisdictions, such as offers addressed to a number of investors — either professional or non-professional — not exceeding the thresholds indicated by the foreign regulator, offers the value of which did not exceed a given threshold, or offers of financial instruments issued by entities with certain requirements of creditworthiness (eg, European central banks), were not applicable in Italy.

Furthermore, the language of the certain exemptions provided for by the National Commission for Companies and the Stock Exchange did not cover all the cases. For example, the exemption described above did not cover stock option plans addressed to the employees (not managers or directors) of the Italian subsidiaries of foreign issuers, thus generating a series of inconveniences and delays in many multinational stock option plans.

In particular, some of these multinational stock option plans required the issue of a prospectus and its approval by the National Commission for Companies and the Stock Exchange for the reason of having been addressed also to the employees of Italian subsidiaries, such category of addressees of the offer not being contemplated under the above exemption; on the other hand, the stock option plans addressed only to the Italian employees and managers of branches (not incorporated) of the mother company or to the managers of subsidiaries did not require the issue of a prospectus.

Finally, the most significant characteristic of the regulatory system preceding the Consolidated Text was that the exceptions to the obligation of issuing a prospectus were provided for by rules with an inferior rank in the hierarchy of the sources of the law (such as a regulation of the National Commission for Companies and the Stock Exchange) and, for this reason, were more liable to changes or abolishment.

Effects of Consolidated Text

The rules of the Consolidated Text have been issued with the purpose of avoiding the inconveniences described in the preceding paragraph. Indeed, the Italian legislator improved both the legislative technique and the contents of the rules. In particular, the Consolidated Text itself provides for, or outlines, a number of 'solicitations for an investment' for which a prospectus is not necessary, which can be considered as private placements. This means that the Italian legislator paid to the private placements a greater attention than to the system of Law Number 216/74.

The expression 'outlines' has been used because some provisions of the Consolidated Text must be implemented by means of Regulations issued by the National Commission for Companies and the Stock Exchange. For example, the Consolidated Text provides that the issues or offers of securities the value of

which does not exceed a given threshold are exempted from the prospectus obligations; accordingly, the National Commission for Companies and the Stock Exchange has determined such threshold by means of a Regulation.

In particular, Regulation Number 11971 has filled in the gaps left by article 100 of the Consolidated Text with regard to some details of certain issues or offers of securities exempted from prospectus obligations. Furthermore, the Consolidated Text granted to the National Commission for Companies and the Stock Exchange the power of determining types of placement for which the rules on the 'solicitation for an investment' apply only in part.

The National Commission for Companies and the Stock Exchange exercised such power and indicated in Regulation Number 11971 some classes of placements which, even though a prospectus must be issued and circulated among potential investors, need not be filed with the National Commission for Companies and the Stock Exchange for prior approval. This means that the issuer or offeror must deliver to the National Commission for Companies and the Stock Exchange a copy of the prospectus when the securities will be actually placed, provided that the same prospectus is drafted in compliance with the general rules on the subject matter. As a consequence, the prospectus circulated for these types of placements is circulated under the issuer's or offeror's sole liability.

Exemptions from Prospectus Obligation

The list of 'solicitations for an investment' not subject to the obligation of issuing a prospectus directly provided for by article 100 of the Consolidated Text consists of the following offers:

- Offers addressed exclusively to 'qualified investors'; it should be noted that the current definition of 'qualified investors' as given in Regulation Number 11971 is now the same as the one of the 'professional investors' under the MiFID and the relevant Italian implementation rules;
- Offers addressed to a number of persons not exceeding the number determined by the National Commission for Companies and the Stock Exchange regulations (for the relevant figure, see below);
- Offers the overall value of which does not exceed the thresholds determined by the National Commission for Companies and the Stock Exchange regulations (for the relevant figure, see below);
- Offers consisting of securities issued or guaranteed by member states of the European Union, or by international public institutions of which one or more member states of the EU are parties;
- Offers consisting of securities issued by the European Central Bank or by central banks of member states of the EU;
- Offers consisting of securities issued by banks, other than shares or financial instruments, which allow the acquisition of shares or insurance products issued by insurance companies; and

- Offers consisting of money market instruments issued by banks with maturity not exceeding 12 months.

Another group of offers exempted from the issue of a prospectus and its prior approval by the National Commission for Companies and the Stock Exchange is provided for by Regulation Number 11971. These offers are the following:

- Being addressed to less than 150 persons;
- Amounting to less than €5,000,000, calculated over a period of 12 months;
- Amounting to less than €100,000 inside the EU, calculated over a period of 12 months;
- Involving securities with a total consideration of at least €100,000 per investor for each separate offer;
- Involving securities of which the denomination per unit is not less than €100,000;
- Involving securities issued with a view to obtaining the means necessary to achieve their non-profit-making objectives by associations with legal status or non-profit-making bodies, recognized by a member state of the EU;
- Involving shares issued in substitution for shares of the same class already issued if the issuing of such new shares does not entail any increase in the issued capital;
- Involving securities offered in connection with a takeover by means of an exchange offer, provided that a document is available containing information which is regarded by the competent authority as being equivalent to that of the prospectus, taking into account the requirements of Community legislation;
- Involving securities offered, allotted, or to be allotted in connection with a merger or a spin off, provided that a document is available containing information which is regarded by the competent authority as being equivalent to that of the prospectus, taking into account the requirements of Community legislation;
- Involving shares offered, allotted, or to be allotted free of charge to existing shareholders, and dividends paid out in the form of shares of the same class as the shares in respect of which such dividends are paid, provided that the company has its registered office in an EU member state and a document is made available containing information on the number and nature of the shares and the reasons for and details of the offer;
- Involving securities offered, allotted, or to be allotted to existing or former directors or existing or former employees by an issuer which has securities already admitted to trading on a regulated market or by the parent company, a subsidiary, an affiliate, or an undertaking subject to joint control, provided that the securities are of the same class as those already admitted to trading on the same market and that a document is made available containing

information on the number and nature of the securities and the reasons for and details of the offer; and

- Having as the subject matter financial instruments which are different from the share capital issued in a continuous or repeated manner by banks and which are not subordinate, convertible, or exchangeable; do not confer the right to subscribe to or acquire other types of financial instruments and are not linked to a derivative instrument; give evidence of receipt of reimbursable deposits; and are covered by a system of deposit guarantees according to articles 96 to 96 *quater* of Legislative Decree Number 385 of 1 September 1993, related to deposit guarantee systems.

As mentioned, Regulation Number 11971 also provides for a 'third gender' of placements. In particular, even though the issue of a prospectus and its circulation among potential subscribers is required for these placements, the issuer or offeror need not obtain from the National Commission for Companies and the Stock Exchange the prior approval of the prospectus; nor must it give prior notice of his intention of placing the relevant securities.

In any case, a copy of the prospectus must be delivered to the National Commission for Companies and the Stock Exchange when the relevant securities will be actually placed. Moreover, the prospectus must be drafted in compliance with the general rules on the drafting of prospectuses and, therefore, it is circulated under the issuer's or offeror's sole liability since there is not a prior control by the National Commission for Companies and the Stock Exchange. The National Commission for Companies and the Stock Exchange remains vested with the power of suspending the placement in case of violations of the applicable rules. These placements are the following:

- Offers having as their object financial instruments offered in option to the shareholders of issuers of listed shares or convertible bonds, or of 'securities diffused among the public' (see text, above);
- Offers the overall value of which does not exceed the threshold of €5 million; and
- Offers addressed to the employees, retired employees, agents, and persons having regular business relationships with the companies indicated above.[13]

Private Placements of UCITS and Collective Investment Schemes

Offers Addressed to Italian Institutional Investors

Private placements in Italy of UCITS and collective investment schemes (as defined above) are subject only partly to Regulation Number 11971, since other rules, including specific rulings of the National Commission for Companies and the Stock Exchange and the Bank of Italy, apply to the subject matter.

13 In such case, the results of the offer must be communicated to the National Commission for Companies and the Stock Exchange.

In particular, the offers only addressed to institutional investors will not be exempted from passporting requirements, thus involving that for such type of offers Italy does not allow the so-called 'private placement exception' but only an exemption from certain prospectus requirements.

Italian Institutional Investors Investing Abroad

According to rulings of the Bank of Italy and the National Commission for Companies and the Stock Exchange, Italian asset managers acting on an individual and discretionary basis are allowed to insert in their investment portfolios units of UCITS or collective investment schemes not registered for marketing in Italy. This permission is grounded on the freedom of the Italian asset managers to approach directly the foreign issuer, or the foreign distributor, in the home country, to purchase units of UCITS or collective investment schemes not registered in Italy. Indeed, the 'initiative' is taken outside the national borders by the Italian entity and, therefore, there is neither a solicitation nor an offer directed by the foreign UCITS, nor its distributor, to Italian investors and, therefore, no registration requirements apply.

Both the Bank of Italy and the National Commission for Companies and the Stock Exchange provide for a series of formalities to avoid that this facilitation be construed as an avoidance of the Italian rules on UCITS and collective investment schemes registration. In particular, the Bank of Italy estimates that an elusion may likely take place if the purchase of the unregistered UCITS and collective investment schemes by Italian asset managers does not have the characteristics of a genuine management of investment portfolios, which is 'personalized', 'customized', and 'dynamic'.

Accordingly, the elements which are in conflict with real asset management are a massive and virtually exclusive use of the unregistered UCITS and collective investment schemes, as well as the absence of sales (redemptions) of them, once they have been inserted in the investment portfolio. According to the National Commission for Companies and the Stock Exchange, the Italian asset manager must acquire adequate information on the unregistered UCITS and collective investment schemes to advise the client on the risks of the investment. Moreover, the organization of the unregistered UCITS must allow the exercise of the rights of the Italian investor also in case of closing of the investment account managed by the Italian asset manager.

Tender Offers for Purchase and Exchange

Voluntary Offers

With regard to tender offers, the Consolidated Text has repealed the existing regulations on tender offers, ie, Law Number 149/92. According to the Consolidated Text, the offeror must previously communicate its intention of organizing a 'voluntary' tender offer to the National Commission for Companies and the Stock Exchange. The National Commission for Companies and the

Stock Exchange may request further information. The offeror must also publish a document, to be previously submitted to the National Commission for Companies and the Stock Exchange, containing information on the offer; this document will be circulated among the holders of the financial products which are the target of the offer.

National Commission for Companies and the Stock Exchange Regulation 11971 provides for an outline for the drafting of the document of the offeror, as well as the formalities for the launch of competing offers. Relaunches will be capable of being made by other offerors without price limits, provided they are made within the fifth day preceding the closing of the first offer.

The duration of the offer may range between 15 and 40 days, and the offer can start at least five days after the approval of the offering document by the National Commission for Companies and the Stock which, by means of a resolution, is entitled to postpone such term to 55 days in the interest of the investors. The Consolidated Text provides that, if the target company is an Italian-listed company, the same company cannot implement defensive tactics, unless these are authorized by the shareholders' meeting. The mere research of other offers is not considered a defensive tactic.

Compulsory Offers

Articles 105–112 of the Consolidated Text govern three cases of compulsory tender offers on Italian companies listed on Italian regulated markets. The first case is the 'subsequent' tender offer. In particular, the acquisition of at least 30 per cent of voting shares of the capital of an Italian-listed company, made either directly or through trust companies or nominates, involves the obligation of the purchaser to tender for all the remaining capital of the relevant listed company. The price per share in such compulsory tender offer is determined according to criteria set forth by the Consolidated Text.

The second case of compulsory tender offer is the 'partial-acquisition takeover bid'. It occurs when the above-mentioned shareholding exceeding 30 per cent is acquired as a result of a public offer to buy at least 60 per cent of the listed securities and the following conditions are satisfied:

- The offeror has not acquired shareholdings exceeding one per cent in the 12 months preceding the notice to be given to the National Commission for the Companies and the Stock Exchange;
- The effectiveness of the offer has been made subject to approval by the shareholders in possession of the majority of securities; and
- The National Commission for Companies and the Stock Exchange grants the exemption after verifying the compliance with the requirements specified in items 1 and 2, above.[14]

14 In such event, the obligation to acquire all securities does not apply.

Finally, the last case of compulsory tender offers is the 'mandatory squeeze-out', according to which, when as a result of a full takeover bid, the bidder holds at least 95 per cent of the capital represented by securities, the acquisition of the remaining securities is mandatory should any other party so request.

Furthermore, still within the context of a compulsory tender offer, any party becoming holder of a quota exceeding 90 per cent of capital represented by securities admitted to trading on a regulated market is obliged to mandatorily squeeze out the remaining securities admitted to trading on a regulated market by any holder thereof unless a float sufficient to ensure regular trading performance is restored within 90 days.

The obligations provided for in the first and the third cases of mandatory offers also apply to parties acting in concert when, as a result of purchases made by even only one of the parties, they come into possession of a total holding exceeding said percentages. Regulation Number 11971 provides for some circumstances in which, even though an acquisition would be subject to a compulsory tender offer, such obligation does not apply. These situations are the following:

- The majority of the voting rights is held by a shareholder or a group of shareholders different from the purchaser;
- The acquisition is made through a capital subscription within the context of an increase of the capital of the target company in connection with the restructuring of its debt following a situation of crisis;
- The participation is acquired through a transaction between companies the majority of which is held, directly or indirectly, by the same persons;
- The threshold is exceeded as a consequence of the exercise of option or conversion rights;
- The 30 per cent threshold is exceeded by no more than three per cent and the purchaser undertakes to sell the exceeding interest within 12 months and not to exercise the relevant voting rights during such period; and
- The threshold is exceeded as a consequence of a merger or of a spin-off approved on the basis of effective and motivated industrial needs and deliberated by a shareholders' meeting of the company the shares of which would otherwise be the object of the offer.

The Consolidated Text provides that a shareholder who is party to a shareholders' agreement can withdraw without prior notice from such agreement if he decides to sell his shares to the offeror in a compulsory 'subsequent' tender offer or in a 'partial-acquisition takeover bid'.

Disclosure of Corporate Information

The Consolidated Text provides for rules on the transparency and the disclosure of corporate information. These rules must be complied with by the entities

which issue financial instruments dealt (or to be dealt) in the Italian regulated markets, with some exceptions for certain types of obligations. In particular, the rules on the issue of a prospectus and on the disclosure of circumstances which may affect the price of the financial instruments do not apply to those public entities for which no prospectus obligations exist (see text, above). Other rules of the Consolidated Text on the transparency apply to Italian listed companies. They concern:

- The existence and the characteristics of the shareholders' agreements (the existence of which must be communicated to the National Commission for Companies and the Stock Exchange and to the Register of Undertakings, as well as the object of a press announcement); and
- The disclosure of the proprietary arrangements in such companies.

In particular, the Consolidated Text has confirmed the rule of Law Number 216/74 according to which the two per cent of the capital represented by shares with voting rights of a company listed in Italy is the lowest threshold for the disclosure obligation to the National Commission for Companies and the Stock Exchange and to the participated company.

Furthermore, by means of Regulation Number 11971, the National Commission for Companies and the Stock Exchange provided that the disclosure obligation arises on the following thresholds of interest being passed: two per cent, five per cent, 7.5 per cent, 10 per cent, and subsequent multiples of five. The disclosure should be made within five days, during which period the markets are open, from the transaction which involved the passing of the threshold, and only special forms approved by the National Commission for Companies and the Stock Exchange should be used for the purpose of such communication.

Proxy Solicitations and Powers of Minorities

The Consolidated Text introduced for the first time in the Italian legal system rules on proxy solicitations. Pursuant to Legislative Decree Number 27 of 2010, amending the Consolidated Text, proxy solicitation can be carried out within 31 October 2010 by investment firms, banks, savings management companies, SICAVs, and companies having the proxy solicitation as their sole purpose.

For those meetings held after 31 October 2010, Legislative Decree Number 27 sets out that solicitation is performed by financial promoters through dissemination of a statement and a proxy form. The vote relating to shares for which proxy is conferred is exercised by the promoter, who may be substituted only by a person specifically indicated in the proxy form and in the solicitation statement. The information contained in the proxy statement or the proxy form and any sent out during a solicitation or collection of proxies must enable shareholders to make an informed decision.

The promoter is liable for the completeness of information sent out during a solicitation. The powers of minority shareholders of listed companies are

regulated by the Civil Code, in particular by articles 2367, 2408, 2409, and 2393 *bis*. These articles cover, respectively:

- The directors' obligation to call a shareholders' meeting on request of the minority;
- Reports of irregularities to the board of statutory auditors and statutory auditors' obligation to promptly inspect and call a shareholders' meeting; and
- Corporate legal action against directors.

Insider Trading

Insider trading is punished with criminal sanctions. The Consolidated Text provides for an extraterritorial enforceability of the rules on insider trading and the circulation of notices which are apt to alter the price of financial instruments, when the above concern financial instruments dealt in Italian regulated markets.

Criminal and Administrative Sanctions

Articles 166–196 of the Consolidated Text provide a list of criminal and administrative sanctions for violations of various rules of the Consolidated Text. The Consolidated Text has introduced a new discipline based on non-criminal penalties (administrative pecuniary sanctions), rather than criminal sanctions, as was the case under Law Number 216/74 and similar provisions.

In this context, the lack of disclosure of a holding in an Italian-listed company, with a delay of more than 30 days, no longer is a crime. Legislative Decree Number 61 of 11 April 2002 introduced a new discipline for the criminal and administrative violations of companies, as set out in articles 2637 and 2638 of the Civil Code and article 622 of the Criminal Code.

Article 2637, in particular, governs the criminal sanctions to be applied to anybody who discloses false or tendentious information with the purpose to influence the price of the financial instruments. Article 2638 replaces articles 171 and 174 of the Consolidated Text, governing the criminal sanctions to be applied in case of obstruction of the supervisory activity by the disclosure of false or misleading information and data rendered to the Bank of Italy or to the National Commission for the Companies and the Stock Exchange.

Article 622 of the Criminal Code provides for sanctions against those professionals or officers who disclose or reveal confidential information gathered in connection with their professional activity or office, or use such confidential information for their own or third parties' profits. Furthermore, Decree Number 179 has introduced in the Consolidated Text fines for breach of the provisions of Short Selling Regulation.

Fines contemplated by the Consolidated Text will be increased when the maximum fine seems inadequate, because of the personal qualities of the

offender, the entity of the profit gained, or by the effects produced on the market. Finally, the application of the fines contemplated by the Consolidated Text entails the confiscation of the product or profit gained through the illicit fact and, if the confiscation is not possible, sums of money, assets, or other benefits of equivalent value will be confiscated.

Japan

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Japan

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Introduction

Regulatory System

Japan is a Civil Law country. After the Meiji Restoration in 1868, when the feudal regime collapsed and the Emperor Meiji's government started modernising Japan, much legislation was introduced with influences from European statutes and legal concepts, such as those of France and Germany. After World War II, the influence from United States legislation was overwhelming during the post-war period. Much new regulatory legislation was adopted and modelled on the United States legislation. In such an environment, the Securities and Exchange Law[1] was enacted.

The Financial Instruments and Exchange Law, formerly known as the Securities and Exchange Law, is a basic law of Japanese securities regulations and, when enacted in 1948, was modelled on the Securities Act of 1933 and the Securities and Exchange Act of 1934 of the United States. The Securities and Exchange Law has been significantly amended more than 30 times since its enactment more than 50 years ago. It has been influenced by United States securities regulations to a large extent. The 2006 amendments to the Securities and Exchange Law, the principal portion of which became effective 2007, have changed the name of the law to the Financial Instruments and Exchange Law.[2] The Financial Instruments and Exchange Law regulates the broad aspects of capital market activities, such as disclosures in the primary and secondary markets. It also regulates market participants, such as financial instruments firms and financial instruments exchanges. In addition to the Financial Instruments and Exchange Law, there are many special laws and regulations which govern particular areas of capital market activities or particular types of market participants.

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1 Securities and Exchange Law, Law Number 25 of 1948, as amended.

2 The amendments also contain significant revisions to the former Securities and Exchange Law. The purpose of the amendments was to establish a legislative framework for investor protection covering a wide range of financial products which used to be regulated separately. Laws such as the Law Concerning Foreign Securities Firms, the Financial Futures Trading Law, the Law Concerning Regulation of Investment Advisory Business Relating to Securities, and the Law Concerning the Regulation of the Mortgage Business were abolished and incorporated into the Financial Instruments and Exchange Law.

Legal Sources

Source of Law

As described above, the Financial Instruments and Exchange Law is the basic law regulating the capital market activities and participants. The Financial Instruments and Exchange Law consists of the following chapters:

- Chapter 1 — General Provisions.
- Chapter 2 — Corporate Disclosures.
- Chapter 2-2 — Disclosures relating to Tender Offers.
- Chapter 2-3 — Disclosure relating to Substantial Holding of Shares.
- Chapter 2-4 — Special Treatments regarding Electronic Disclosure.
- Chapter 2-5 — Provision and Announcement of Specific Securities Information.
- Chapter 3 — Financial Instruments Firms.
- Chapter 3-2 — Financial Instruments Introducing Brokerage Firms.
- Chapter 4 — Securities Dealers Associations.
- Chapter 4-2 — Investor Protecting Fund.
- Chapter 5 — Financial Instruments Exchanges.
- Chapter 5-2 — Foreign Stock Exchanges.
- Chapter 5-3 — Financial Instruments Transaction Clearing Organisations.
- Chapter 5-4 — Securities Finance Companies.
- Chapter 6 — Regulations relating to Trading of Securities.
- Chapter 6-2 — Monetary Penalty.
- Chapter 7 — Miscellaneous Provisions.
- Chapter 8 — Penal Provisions.
- Chapter 9 — Investigations of Irregularities.

The Enforcement Order Concerning Financial Instruments and Exchange Law has been issued under the Financial Instruments and Exchange Law. Numerous Ministerial Ordinances have been issued under the Financial Instruments and Exchange Law and the Enforcement Order. There are laws which govern special areas of securities regulation of which, among others, particular attention should be paid to the Financial Instruments Investment Trust Law.[3]

Administrative Guidance

In addition to the laws and regulations described above, each of which has the force of law, officers of the competent authorities used to exercise their power of administrative guidance by issuing numerous circulars and notices, which did not have the force of law, but which expressed the authority's view on the interpretation of law or the policy of the

3 Securities Investment Trust Law, Law Number 198 of 1951.

administration which was expected to be complied with or, in certain cases, set forth the detailed procedures to implement the regulatory requirements.

Non-compliance with such administrative guidance did not necessarily result in the violation of law, but the compliance was expected by the authorities and, in fact, market participants complied with the administrative guidance to maintain good relationships with the supervisory authorities and conduct their business smoothly. Therefore, the administrative guidance also was very important for the market participants.

To enhance the transparency of government administration, the Ministry of Finance announced in June 1998 the abolition of its practice of publishing administrative guidance. In its place, the necessary procedures have been, or will be, incorporated into the appropriate laws and regulations, and internal procedures to handle matters within a particular jurisdiction have been compiled in the procedural guidelines. The procedural guidelines do not have the force of law, but remain important as in the case of the administrative guidance.

Rules of the Financial Instruments Exchanges

If an institution is a member or trading participant[4] of a financial instruments exchange,[5] or if securities are listed on a financial instruments exchange, such institution or the parties involved in the transaction of such securities must comply with the rules of such exchange.

Rules of the Japan Securities Dealers Association

In accordance with the Financial Instruments and Exchange Law, the Japan Securities Dealers Association has been organised. Almost all securities firms registered pursuant to the Financial Instruments and Exchange Law are members of the Japan Securities Dealers Association, and the Japan Securities Dealers Association serves as a self-regulatory organisation for securities firms. Therefore, any transactions involving a Japan Securities Dealers Association member are subject to rules of the Japan Securities Dealers Association.

Authorities

The Minister of Finance (and the Ministry of Finance) used to have strong and comprehensive power over the Japanese capital market. Some of the powers of the Ministry of Finance under the Securities and Exchange Law were transferred to the Cabinet Office and the Financial Supervisory Agency, which was newly established in 1998 under the Law Concerning Establishment of the Financial Reconstruction Committee.[6]

4 'Trading financial instruments participants' means financial instruments firms that are qualified to trade securities at the relevant financial instruments exchange in their own names.
5 The former stock exchange now falls into the category of financial instruments exchange.
6 Law Concerning Establishment of the Financial Reconstruction Committee, Law Number 130 of 1998.

The Financial Supervisory Agency was attached to the Financial Reconstruction Committee, which was established in 1998 under the Law to deal with the financial crisis in Japan resulting from the Japanese 'bubble' economy being over. Until the next reformation in 2001, the Ministry of Finance, the Cabinet Office, and the Financial Supervisory Agency had regulated the Japanese financial market. The administrative system in Japan was reorganised effective as of January 2001, pursuant to the Law Concerning Reform of Governmental Authorities.[7]

The reorganisation was made for the purpose of strengthening the power of the Cabinet Office and downsizing, and ensuring efficiency of, governmental authorities. The Financial Supervisory Agency and the Financial Reconstruction Committee were united to the Financial Services Agency that was attached to the Cabinet Office.

Prime Minister

All of the powers granted to the Ministry of Finance were transferred to the Prime Minister due to the establishment of the Financial Services Agency. Almost all of those powers are entrusted to the Financial Services Agency under the Financial Instruments and Exchange Law.

Financial Services Agency

The Financial Services Agency is attached to the Cabinet Office and is in charge of:

- The supervision of the banking, insurance, securities, and other financial industries; and
- Surveillance to secure the fairness of securities and other financial transactions.

The Securities and Exchange Surveillance Commission, which was attached to the Ministry of Finance (and then to the Financial Supervisory Agency), is now attached to the Financial Services Agency. The supervision of the financial industries used to be within the jurisdiction of the Ministry of Finance, but currently it belongs to the Financial Services Agency.

Securities and Exchange Surveillance Commission

In General. The Securities and Exchange Surveillance Commission (the 'Commission') consists of three commissioners with supporting staff, and it performs a variety of duties.

Investigation of Irregularities. The officials of the Commission have authority to investigate irregularities. 'Irregularities' means offences which undermine the fairness of the securities transactions, which include the following:

- Filing of a securities registration statement which contains material misstatements;
- Market manipulation; and
- Use of unlawful devices or schemes in effecting the securities transactions.

7 Law Concerning Reform of Governmental Authorities, Law Number 103 of 2000.

Investigation of Securities Companies. In addition to the authority to investigate irregulatories, the Commission has authority to investigate the business and assets of securities companies, financial instruments exchanges, the Japan Securities Dealers' Association, and issuers of securities listed on financial instruments exchanges or traded over the counter.

Investigation of Other Institutions. Furthermore, the Commission has authority to investigate other securities-related institutions, including investment trust management companies.

Japan Securities Dealers Association

As a self-regulatory organisation, the Japan Securities Dealers Association promulgates numerous rules which regulate its members. Almost all the registered securities firms and certain other financial institutions are members of the Japan Securities Dealers Association. The Japan Securities Dealers Association rules must be referred to when a transaction is executed with the involvement of the Japan Securities Dealers Association member firm.

Financial Instruments Exchanges

The financial instruments exchanges, which include stock exchanges, also are self-regulatory organisations. When a transaction is executed with the involvement of a member or trading participant of a financial instruments exchange, the rules of such exchange must be referred to, whether or not such transaction is executed on the exchange.

Other Associations

There are other associations, such as the Securities Investment Trust Association, of which securities investment trust management companies and securities companies are members, and the Securities Investment Advisory Business Association, of which investment advisory and agency firms and investment management firms investment advisers are members. These associations also promulgate rules and guidelines addressed to their respective members, and these rules and guidelines also may need to be considered to execute transactions with such members.

Overview of Securities Regulations

In General

The Financial Instruments and Exchange Law regulates the issuance, trading, and other transactions of securities. For the purposes of the Financial Instruments and Exchange Law, securities are defined to mean:

- Government bonds;
- Local government bonds;
- Bonds issued by a juristic person in accordance with a special law;

- Debentures provided for in the Law Concerning Securitisation of Assets;[8]
- Debentures;
- Investment certificates issued by a juristic person established under a special law;
- Preferred investment certificates or certificates representing subscription rights to new preferred investments provided for in the Law Concerning Preferred Investment to Financial Institutions in the Form of Associations;[9]
- Preferred investment certificates or certificates representing subscription rights to preferred investments provided for in the Law Concerning Securitisation of Specified Assets;
- Share certificates, representing share subscription warrants and certificates representing stock acquisition rights;
- Beneficial certificates (including foreign beneficial certificates) of investment trusts (including foreign investment trusts) provided for in the Law Concerning Investment Trusts and Investment Companies;
- Investment certificates (including foreign investment certificates) provided for in the Law Concerning Investment Trusts and Investment Companies;
- Beneficial certificates of loan trusts;
- Beneficial certificates of special purpose trusts provided for in the Law Concerning Securitisation of Assets;
- Promissory notes issued by a juristic person for raising funds necessary to engage in business and which are prescribed by a Cabinet Office's Ordinance (ie, commercial paper);[10]
- Mortgage Securities provided in the Mortgage Securities Law;[11]
- Securities or certificates issued by foreign countries or foreign juristic persons which are of the same nature as those mentioned in the preceding respective items (excluding beneficial certificates and investment certificates provided for in the Law Concerning Investment Trusts and Investment Companies);
- Securities or certificates which are issued by foreign juristic persons and which represent beneficial rights under trusts which hold the loan claims of banks or other persons engaging in the loan business, or other rights of the same nature prescribed by a Cabinet Office's Ordinance;
- Securities or certificates issued by a person who accepts deposit of securities or certificates mentioned in the preceding respective items outside a jurisdiction in which securities or certificates so deposited were issued and representing rights to securities or certificates so deposited (ie, depositary receipts);

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8 Law Concerning Securitisation of Assets, Law Number 105 of 1998.

9 Law Concerning Preferred Investment to Financial Institutions in the Form of Associations, Law Number 44 of 1993, as amended.

10 Cabinet Office's Ordinance Concerning the Definition Prescribed in article 2 of the Financial Instruments and Exchange Law, Ministry Ordinance Number 14 of 1993.

11 Law Number 15 of 1993.

- Securities or certificates which are prescribed by an Enforcement Order to secure the public interest or the protection of investors in light of their negotiability or other circumstances (currently, negotiable certificates of deposit issued by foreign juristic persons are prescribed by the Enforcement Order);[12]
- Beneficial rights (whether or not represented by certificates) under trusts;
- Rights (whether or not represented by certificates) which are issued by foreign juristic persons and which are of the same nature as those mentioned in the immediately preceding item;
- Equity interests in *gomei kaisha*, *goshi kaisha* (to the extent prescribed by the Enforcement Order), or *godo kaisha*, or equity interests of foreign juristic person which are of the same nature as those mentioned in this item;
- The right to receive dividends or distribution of assets arising out of the business that uses cash, securities, bills of exchange, and promissory notes contributed by equity owners (equity partners) to the extent that such right is not included in any one of the following (securities mentioned in this item and the immediately preceding three items (except for those involving issuance of certificates) are referred to as 'deemed securities'): (a) Other kinds of securities; (b) The right of an equity partner when all equity partners are involved in a business for investments; (c) The right with a condition that dividends or distribution of assets to an equity partner may not exceed the amount of his capital contribution; (d) The right based on an insurance contract, a mutual aid contract under the Agricultural Cooperative Law, a mutual aid contract under the Small and Medium-Sized Enterprise Cooperative Association Act, or a contract under the Real Estate Specified Joint Business Law; (e) The right based on cooperative associations in which participation is restricted to certified public accountants, lawyers, judicial scriveners, land and house surveyors, certified administrative procedures specialists, certified tax accountants, certified real estate appraisers, certified social insurance labour consultants, or patent attorneys, and those whose exclusive businesses for investment constitute the operation of such businesses; (f) The right based on a stock ownership plan; (g) The right relating to capital contribution for a corporation established in accordance with the laws and regulations of Japan (except for a limited-liability intermediate corporation); and (h) The right based on a contract relating to shared forest systems based on the Special Measures Law Concerning Shared Forest Systems;
- Monetary claims (whether or not represented by certificates) which are prescribed by an Enforcement Order to be necessary and adequate for the public interest or the protection of investors in light of their status of distribution or other circumstances (currently, there are no such claims prescribed by the Enforcement Order); and
- Securities or certificates representing options on securities or certificates mentioned in the preceding respective items (ie, covered warrants).

For the purposes of the Financial Instruments and Exchange Law, the above list is restrictive and not illustrative. Accordingly, if an instrument does not fall within any of the categories listed above, such instrument is not a security under the Financial Instruments and Exchange Law.

12 Financial Instruments and Exchange Law, Enforcement Order Number 321 of 1965.

Under the Securities and Exchange Law, 'securities business' means the business of buying and selling of securities (dealer), acting as broker, intermediary, or agent in connection with securities transactions (broker), underwriting of securities (underwriter), and/or selling or distributing of securities (distributor). Under the Financial Instruments and Exchange Law, 'financial instruments business' includes investment advisory business, investment management business, acting as broker or agent in concluding agreements regarding investment advisory or investment management agreements, custody of securities, and/or book-entry transfers for bonds, as well as securities business under the former Securities and Exchange Law. Financial instruments business can be conducted only by companies registered with the Financial Services Agency, except that banks may conduct securities business in accordance with the Financial Instruments and Exchange Law and other relevant laws.

The Financial System Reform Law has introduced a new definition for the 'over-the-counter securities derivative transaction', and 'business involving the over-the-counter securities derivative transaction' is included within 'securities business'. 'Over-the-counter securities derivative transaction' means a forward transaction on securities or over-the-counter securities indices, an over-the-counter securities option transaction, an over-the-counter swap transaction on securities, or an over-the-counter securities index. As for derivatives, the former Securities and Exchange Law used to be applied only to derivatives underlying assets of which were either securities or securities indices. The Financial Instruments and Exchange Law expanded the scope of underlying assets so that 'derivatives' should now include interest rate and currency swaps, credit derivatives, and weather derivatives. Derivative transactions are divided into three categories: market derivative transactions (traded at domestic markets), foreign market derivative transactions (traded at foreign markets), and over-the-counter derivative transactions (traded at other than financial instruments markets or foreign financial instruments markets). The business of buying and selling securities by means of electronic data processing devices based on a price of securities on financial instruments exchanges or in over-the-counter markets or a price determined by negotiation or acting as an intermediary in such transactions by means of electronic data processing devices have been included in the definition of 'financial instruments business'.

Corporate Disclosure

In General

The Financial Instruments and Exchange Law provides the disclosure requirements in connection with the public offering of securities and the ongoing disclosure requirements.

Public Offerings

The disclosure requirements of the Financial Instruments and Exchange Law apply both to public offerings in Japan of newly issued securities (primary public offerings) and to public offerings in Japan of previously issued and outstanding securities (secondary

public offerings). Pursuant to the Financial Instruments and Exchange Law, solicitation of an offer to buy newly issued securities constitutes a primary public offering, unless it is made:

- In the case of securities other than deemed securities;
- Exclusively to qualified institutional investors and the securities are of a kind 'unlikely to be transferred to persons other than qualified institutional investors';
- Exclusively to professional investors by registered financial instruments business operators under entrustment from their clients and the securities are of a kind 'unlikely to be transferred to persons other than professional investors'; or
- To fewer than 50 persons and the securities are of a kind 'unlikely to be transferred to many persons'; and
- In the case of deemed securities, the number of purchasers of the financial instruments is less than 500 as a result of the offering of the financial instruments.

For the purposes of both of the exceptions above, 'private shares' are the only equity shares that will constitute securities that are 'unlikely to be transferred to many persons'. Private shares are shares of the same class as shares previously issued by the same issuer which are not:

- Listed on a financial instruments exchange in Japan;
- Registered with the Japan Securities Dealers Association as over-the-counter shares;
- Fungible with shares that were previously the subject of a public offering in connection with which a securities registration statement (or a supplemental document to a shelf registration statement, as the case may be) was filed with the Financial Services Agency; and
- Owned by 500 or more persons in Japan as recorded at the end of any of the most recent four consecutive fiscal years.

Since the last item is applicable only to Japanese entities, shares of foreign entities of which there are 500 or more shareholders in Japan, but that do not meet any of the first three requirements, are classified as private shares.

Debt securities accompanied by an option to convert into, exchange for, purchase from issuers, or subscribe shares that are not 'private shares' cannot enjoy any of the exceptions above. As provided in the Financial Instruments and Exchange Law, a 'qualified institutional investor' is someone with expert knowledge of and experience in investment in securities. Only those institutions enumerated in the relevant Cabinet Office's Ordinance, such as financial instruments firms, banks, or insurance companies and certain foreign governmental agencies, qualify as 'qualified institutional investors'.

In addition, 'professional investors' are defined as qualified institutional investors, the government of Japan, Bank of Japan, and other juridical persons designated by the relevant Cabinet Office's Ordinance. A juridical person or an individual that does not fall in the category of a professional investor can be deemed to be a professional investor by their own request. In addition, a professional investor can be deemed not to be a professional investor by their own request, although an individual must generally satisfy the requirements provided by the Cabinet Office's Ordinance as equivalent to a professional investor, in light of his knowledge, experience, and state of property.

In the case of securities other than deemed securities, the number of offerees of the several primary offerings made within the last six months, other than:

- A primary offering in connection with which a securities registration statement or a supplemental document to a shelf registration statement, as the case may be, was filed with the Financial Services Agency; and
- A primary offering which enjoyed the first exception, above (ie, an offering made exclusively to qualified institutional investors) will be aggregated to the number of offerees of the primary offering in question to determine whether the primary offering in question will constitute a primary public offering.

Pursuant to the Financial Instruments and Exchange Law, a 'secondary public offering' is, with the same exceptions where an offering is made exclusively to professional investors, an offer to sell or a solicitation of an offer to buy previously issued and outstanding securities, in the case of securities other than deemed securities, where such offer or solicitation is made 'on uniform terms and conditions' to 50 or more persons in Japan, and in the case of deemed securities, where the number of purchasers of the financial instruments is 500 or more, as a result of the offering. According to the official interpretation, 'uniform terms and conditions' means the same offer price and the same delivery date. Since the legal requirements discussed below generally apply to both primary and secondary public offerings, the term 'public offering' alone will be used below to apply to both types.

Securities Registration Statement

Pursuant to the Financial Instruments and Exchange Law, to make a public offering in Japan, an issuer must file a securities registration statement with the Financial Services Agency with three exceptions. Subject to these exceptions, no public offering may be made after the filing of the securities registration statement.

First, for any public offering, no securities registration statement filing is required in the case where the aggregate offer price of the securities is less than ¥100 million (or its equivalent in other currency). In determining whether the ¥100 million threshold has been reached, the value of securities of a kind issued by the same issuer ('equivalent securities') which were offered in an offering (whether primary or secondary) made within the last two years (other than a public offering in connection with which a securities registration statement — or a supplemental document to a shelf registration statement, as the case may be — was filed with the Financial Services Agency and a public offering which was made before such filing) will be aggregated.[13] Furthermore, if an offering (whether primary or secondary) of securities with an aggregate offer price of less than ¥100 million is undertaken at the same time as an offering (whether primary or secondary) of equivalent securities with an aggregate offer price of less than ¥100 million and the sum of the

13 If the offering in question constitutes a primary public offering as a result of aggregation of the number of offerees in several primary offerings within the last six months, the amount of securities of such several primary offerings will be added to an amount of securities offered in the offering in question.

aggregate offer price of both offerings is ¥100 million or more, an aggregate offer price of each of both offerings is deemed to be ¥100 million or more.

Second, if an offering is made to persons designated by an Enforcement Order as persons who have already obtained or can easily obtain information with regard to offered securities, filing of a securities registration statement is not required. In this regard, when an offering of stock acquisition rights is made to the issuer's directors and/or employees, the issuer is not required to file a securities registration statement.

Third, filing of a securities registration statement is not required in a secondary public offering of securities if disclosure with regard to the securities has already been made where:

- The public offering of equivalent securities for which a securities registration statement was filed and became effective was made prior to such secondary public offering or where equivalent securities are listed on a Japanese financial instruments exchange or registered with the Japan Securities Dealers Association as over-the-counter securities; and
- The issuer has satisfied the Japanese continuous disclosure requirements.

Although the filing of a securities registration statement is not required, a prospectus must be prepared as if the securities registration statement were required to be filed.

Fourth, in the case of securities other than deemed securities, if the original offering of securities was made exclusively to qualified institutional investors and the securities are of a kind unlikely to be transferred to persons other than qualified institutional investors and the secondary public offering in question is made exclusively to qualified institutional investors, no securities registration statement filing is required.

The form and substance of the securities registration statement are stipulated in the relevant Cabinet Office's Ordinance. The securities registration statement should be prepared in Japanese. For Japanese private sector issuers which are not qualified to use a simplified securities registration statement, the form designated as Form 2 should be used for the securities registration statement. The securities registration statement on Form 2 consists of four parts. Part I provides information concerning the securities to be offered (ie, the timetable for offering, pricing, structure of underwriting, and similar matters). Part II includes information concerning the issuer, and Part III includes information concerning a guarantor (if any). Part IV should include certain additional financial information and the form of the certificates of the securities. Additionally, various documents or instruments (such as certified copies of the charter document and board resolutions) must be filed with the Financial Services Agency as exhibits to the securities registration statement. In the case of a public offering by a Japanese corporation with an aggregate offer price of less than ¥500 million (or its equivalent in another currency), such Japanese corporation is entitled to simplify the information to be contained in Part II of its securities registration statement in accordance with the relevant Cabinet Office's Ordinance, unless such Japanese corporation has already made the public disclosure without such simplification. In determining whether the ¥500 million threshold has been reached, the value of securities offered in other offerings will be aggregated in some cases.

As to timing considerations, one week or more before the official filing of the securities registration statement, a draft of the securities registration statement is to be submitted to the Financial Services Agency for its informal review. After the official filing of the securities registration statement, the offer to sell or the solicitation of offers to buy may commence, but the securities can actually be sold through the offering only after the registration becomes effective. The registration becomes effective on the expiration of a 15-day waiting period after its official filing. If an amendment to the securities registration statement is filed, the 15-day period begins to run again, but the Financial Services Agency has discretion to shorten the waiting period or to declare the registration immediately effective. In practice, the Financial Services Agency, at the request of the issuer and absent exceptional circumstances, regularly reduces the waiting period, as described below.

At least one amendment to the securities registration statement in fact should be filed, to disclose the pricing terms and other matters, which are not determined at the time of the original filing. After the filing of the final amendment and the request of the issuer, under the Financial Instruments and Exchange Law, the Financial Services Agency is authorised to shorten, and ordinarily in practice does shorten, the waiting period to a minimum of one business day after such filing, after which the registration becomes effective. In certain circumstances, the relevant financial authority allows the registration to become effective on the business day after such filing.

The Financial Instruments and Exchange Law has given the Financial Services Agency the authority to declare the securities registration statement effective immediately on the filing of the final amendment, and the Financial Services Agency exercises this authority in the case where the offering was conducted by way of book-building. If the following conditions are satisfied, an issuer is eligible to use a simplified securities registration statement for offering of shares:

- The issuer files an annual securities report continuously for one year or more;
- Shares of the issuer are listed on any of the Japanese stock exchanges or registered with the Japan Securities Dealers' Association; and
- (a) Either the average annual trading volume of the shares of the issuer on such stock exchange or over-the-counter market for certain years is not less than ¥10 billion and the average annual volume of the shares listed or registered on such stock exchange for certain years is not less than ¥10 billion; or (b) the average annual volume of the shares listed or registered for certain years is not less than ¥25 billion; (c) a credit-rating agency designated by the Minister of Financial Services has assigned a qualified credit rating to one series of bonds issued by the issuer and another such credit-rating agency has assigned a qualified credit rating to the same or a different series of bonds including those to be offered; or (d) the issuer has issued bonds (excluding bonds convertible into, or with warrants to subscribe, shares) assured by law of priority of payment.

For these purposes, a 'qualified credit rating' means a long-term credit rating of the BBB or higher. By amendments to the relevant Cabinet Office's Ordinance, a Japanese

or non-Japanese corporation is entitled to use a simplified securities registration statement in the case of offering of bonds if:

- It files a securities report continuously for one year or more; and
- The issuer meets the criteria specified in (c), above.

Thus, with respect to bonds, the share listing or registration requirement has been lifted. In the case of a simplified securities registration statement, the issuer can incorporate its continuous disclosure documents (ie, an annual securities report, semi-annual report, and extraordinary report) into a securities registration statement by reference. As a result, Part II (information concerning the issuer) of the securities registration statement (which is the most voluminous) can be omitted. Furthermore, the 15-day waiting period is shortened to seven days. If the issuer satisfies only the first condition, above (ie, the issuer files an annual securities report continuously for one year or more), the issuer can qualify to use another type of simplified securities registration statement. In this case, the issuer can physically incorporate into a securities registration statement an annual securities report and its attachments and a semi-annual report.

Prospectus

An issuer subject to the securities registration statement is also required under the Financial Instruments and Exchange Law to prepare a prospectus and, as indicated in the text, above, relating to 'Public Offerings', even if a securities registration statement filing is not required in the case of a secondary public offering of securities in which disclosure with regard to the securities has already been made, a prospectus must nonetheless be prepared. However, if the aggregate offer price of securities in such secondary public offering is less than ¥100 million, a prospectus need not be prepared.

The prospectus is substantially a reproduction of Parts I, II, and III of the securities registration statement.[14] A preliminary prospectus (similar to a 'red herring') may be used before the registration becomes effective for the purpose of disseminating information to the public, but the sale of securities cannot, in any event, be concluded before the registration becomes effective. A preliminary prospectus does not include such matters as the pricing terms. Thus, a final prospectus should be generally prepared, but the issuer may, in place of a final prospectus, attach separate printed updates to amend the preliminary prospectus. The delivery of this final pricing amendment to the preliminary prospectus can be omitted if the preliminary prospectus specifically states that the pricing information will be published in two daily newspapers or one daily newspaper and website of underwriting securities companies and such publication is actually made.

The 2004 amendment to the Financial Instruments and Exchange Law has abolished the strict prohibition of the use of offering materials containing the different information from

14 The amendment to the Financial Instruments and Exchange Law, effective 1 December 2004, divides prospectuses into those to be distributed to all of investors and those to be distributed upon request of investors with regard to beneficial certificates of investment trusts and investment certificates. In sum, the first is more concise than the second.

that in the prospectus. However, offering materials may not contain untrue statements or misleading statements. Therefore, the 'roadshow' can be conducted shortly after the filing of the securities registration statement.

Shelf Registration

The Financial Instruments and Exchange Law provides for a 'shelf registration' system which is comparable to the shelf registration system in the United States. An issuer which meets the same criteria as that for the eligibility for using a simplified securities registration statement (ie, securities registration statement into which the issuer's information is incorporated by reference) and which intends to offer securities in an amount of ¥100 million or more during the effective period of shelf registration may utilise the shelf registration system.

A shelf registration is made by filing with the Financial Services Agency a shelf registration statement, which needs to state only limited information, such as the kind of securities to be offered under the shelf registration and the aggregate amount of the securities to be offered. The effective period of the shelf registration is one year or two years, as elected by the issuer. During such period, the issuer may undertake solicitations, and sell the securities one day after filing with the Financial Services Agency a 'supplemental document to the shelf registration statement' which states the details of the securities.

Specified Offerings

The registration requirements under Japanese law explicitly apply only to public offerings in Japan. Under the Financial Instruments and Exchange Law, a securities registration statement needs to be filed only in the event of a (primary or secondary) public offering, unless such public offering falls within one of the three exceptions discussed in the text, above, relating to 'Public Offerings', that exempt the issuer from filing a securities registration statement.

However, if a public offering falls within such an exception but the public offering constitutes a 'specified offering', the issuer must file a 'securities notice' no later than one day prior to the commencement of the 'specified offering'. A 'specified offering' is:

- A public offering in which the aggregate offer price is less than ¥100 million (but, if the aggregate offer price is not more than ¥10 million, the securities notice filing requirement does not apply); or
- A secondary public offering of securities with regard to which disclosure has already been made.

With respect to a specified offering as described in the second item, above, a prospectus must be prepared and distributed to investors as if a securities registration statement were filed.[15] In the case of other types of specified offerings, any offering documents can be used.

15 If the aggregate offer price is less than ¥100 million, the prospectus requirement does not apply.

Private Placements

The term 'private placement' means an offering of securities which do not constitute a public offering under the Financial Instruments and Exchange Law. In other words, a private placement of newly issued securities is:

- In the case of securities other than deemed securities;
- A solicitation of an offer to buy securities made to fewer than 50 persons that are of a kind unlikely to be transferred to many persons (small private placement);[16]
- A solicitation of an offer to purchase securities made exclusively to qualified institutional investors that are of a kind unlikely to be transferred to persons other than qualified institutional investors (private placement to qualified national investor);
- A solicitation of an offer to buy securities made exclusively to professional investors by registered financial instruments business operators under entrustment from their clients and the securities are of a kind unlikely to be transferred to persons other than professional investors ('private placement to professional investors'); or
- In the case of deemed securities, a solicitation of an offer to purchase securities if the number of purchasers of the financial instruments is less than 500 as a result of the offering.

For the purpose of a private placement to be deemed 'unlikely to be transferred to many persons', the following arrangement must be ensured:

- In the case of shares, the shares are 'private shares' (see text, above, relating to 'Public Offerings'); and
- In the case of bonds (other than bonds accompanied by an option to convert into, exchange for, purchase from issuers, or subscribe shares), the bonds are exclusively in registered form, transfer (other than transfer of bonds purchased to another single purchaser) is restricted, such restriction is stated in the certificates of the bonds, the number of certificates of the bonds (plus the number of certificates of equivalent bonds newly issued within the last six months) is less than 50, the bonds cannot be divided into smaller denomination in nature or by terms of the bonds, and such restriction on the division is stated in the certificates of the bonds.

For the purpose of a private placement to be deemed 'unlikely to be transferred to persons other than professional investors', the following arrangement must be ensured:

- In the case of shares, the shares are 'private shares' and investors agree not to transfer such shares to persons other than professional investors; and
- In the case of bonds (other than bonds accompanied by an option to convert into, exchange for, purchase from issuers, or subscribe shares), the bonds are 'private bonds' and investors agree not to transfer such bonds to persons other than professional

16 Qualified institutional investors are not taken into account for the purpose of the calculation of this 50-person requirement if the qualified institutional investors is 250 or less and such institutional investors agree to the transfer restriction as provided for in the Enforcement Order Concerning Financial Instruments and Exchange Law.

investors. 'Private bonds' means bonds previously issued by the same issuer which are not listed on a financial instruments exchange in Japan, registered with the Japan Securities Dealer Association as over-the-counter bonds, fungible with bonds that were previously the subject of a public offering in connection with which a securities registration statement (or a supplemental document to a shelf registration statement, as the case may be) was filed with the Financial Services Agency, or owned by 500 or more persons in Japan as recorded at the end of any of the four most recent consecutive fiscal years.

For the purpose of a private placement to be deemed 'unlikely to be transferred to persons other than qualified institutional investors', the following arrangement must be ensured:

- In the case of shares, the shares are 'private shares' and investors agree not to transfer such shares to persons other than qualified institutional investors;
- In the case of registered bonds, the bonds are exclusively in registered form, transfer to persons other than qualified institutional investors is restricted, such restriction appears on the name of the bonds, and such restriction is stated in the certificates of the bonds; and
- In the case of bearer bonds, the bonds are exclusively in bearer form, transfer to persons other than qualified institutional investors is restricted, such restriction appears on the name of the bonds, solicitation is made on the condition that purchasers will agree to such restriction, and prospective purchasers agree to record the bonds under the Japanese bond recording system.

Persons who make a private placement of newly issued securities must give purchasers of securities a written notice stating that a securities registration statement is not filed in connection with the placement and that transfer of securities purchased in the placement is restricted as described above. The written notice must be delivered prior to, or at the time of, sale of the securities. Except for a private placement to professional investors, the notice requirement is not applied when disclosure under the Financial Instruments and Exchange Law was already made with respect to securities equal to the securities placed or when the aggregate offer price is less than ¥100 million.

Unlike private placement of newly issued securities, resale restriction is not imposed in respect of private placement of previously issued and outstanding securities, with the same exceptions where the solicitation of an offer to buy securities is made exclusively to professional investors. However, in principle, the resale of outstanding securities issued outside Japan and purchased through a private placement is restricted to:

- A resale to non-residents of Japan; or
- A resale of the entire amount of securities so purchased to another single purchaser.

Persons who make a private placement of securities issued outside Japan must give purchasers of securities a written notice stating that disclosure under the Financial Instruments and Exchange Law is not made in connection with the securities placed and that transfer of securities purchased in the placement is restricted as described

above. The written notice must be delivered prior to, or at the time of, sale of the securities. Such resale restriction is exempted if:

- Disclosure with regard to the securities already has been made in accordance with the Financial Instruments and Exchange Law; or
- The aggregate offer price is less than ¥100 million.

All of the following requirements are met:

- The periodical disclosure is made in accordance with the laws of a foreign country or the rules of the relevant foreign stock exchange;
- In the case of placement by securities firms to persons other than qualified institutional investors, the securities firms deliver to investors a document explaining the securities in accordance with the rules of the Japan Securities Dealers Association and the securities firms which accept the deposit of the securities agree to deliver to holders of the securities on their request a document explaining the securities in accordance with the rules of the Japan Securities Dealers Association; and
- The offerees are securities firms or, as to placement of qualified institutional investors, such investors agree not to transfer the securities except for transfer to securities firms or non-residents of Japan, or solicitation is made by securities firms, and purchasers agree to deposit the securities with such securities firms.

Prospectus requirements do not apply to a private placement, and any offering documents can be used.

Offerings in Organisational Restructurings

Under the Financial Instruments and Exchange Law, issuance of new securities or delivery of previously issued securities, on the occasion of organisational restructure of corporations (ie, merger, corporate demerger, stock-for-stock exchange, and stock transfer), may be treated as public offerings if the number of persons who are delivered with such securities is:

- In the case of securities other than deemed securities, 50 or more; and
- In the case of deemed securities, 500 or more.

Continuous Disclosure. Various periodic and other disclosures are required of the issuers of securities which were offered to the public in Japan or which are listed on one of the stock exchanges in Japan or traded on the over-the-counter market in Japan in accordance with the rules of the Japan Securities Dealers' Association. Such requirements are generally founded on the Financial Instruments and Exchange Law and the ordinances promulgated thereunder, as well as on the financial instruments exchange rules.

Exempt Securities. The disclosure and filing requirements are not applicable to certain securities. Such securities include Japanese government bonds, bonds issued by Japanese local governments, beneficial certificates of loan trusts, bonds in respect of which repayment and payment is guaranteed by the Japanese government, and bonds which are issued by organisations established under treaties to which Japan is a party and the offering of

which in Japan is subject to the consent of the Japanese government pursuant to such treaties. The World Bank, the International Bank for Reconstruction and Development, and the Asian Development Bank are among such organisations.

The beneficial certificates of securities investment trusts used to be exempted from the disclosure and filing requirements under the Financial Instruments and Exchange Law since securities investment trusts are governed by the Securities Investment Trust Law. The securities investment trust is a type of investment fund, but the subject of investment is limited to securities. Under Japanese law, investment funds in corporate form were prohibited.

The Law Concerning Securities Investment Trusts and Securities Investment Companies (formerly the Securities Investment Trust Law) has introduced investment funds in corporate form. In addition, the Financial Instruments and Exchange Law, amended by the Financial System Reform Law, has subjected beneficial certificates on securities investment trusts and investment securities issued by securities investment companies to the disclosure requirement under the Financial Instruments and Exchange Law described above. The Law Concerning Securities Investment Trusts and Securities Investment Companies was further renamed as the Law Concerning Investment Trusts and Investment Companies when the coverage of it was widened to include investment trust products for real estate and monetary claims as well as securities. All certificates and securities issued pursuant to this law, including investment trust products for real estate, are subject to the disclosure requirements of the Financial Instruments and Exchange Law.

Disclosure Relating to Tender Offers

If shares of a company which is subject to continuous disclosure requirements under the Financial Instruments and Exchange Law are purchased outside the financial instruments exchange, such purchase must be made by way of a tender offer unless such purchase qualifies one of the exempted transactions. Exempted transactions include the following:

- Purchase effected in the over-the-counter market in accordance with the Japan Securities Dealers Association rules;
- Purchase where the total holdings of the shares by the purchaser and his specially related persons do not exceed five per cent of the total outstanding shares;
- Purchase from a small number of sellers where the total holdings of the shares by the purchaser and his specially related persons do not exceed one-third of the total outstanding shares;
- Purchase from his specially related persons; or
- Purchase by exercising warrants.

An amendment to the Securities and Exchange Law, effective 9 July 2005, added certain off-hour trading similar in effect to off-exchange trading to the scope of tender offer regulations. In addition, the new Financial Instruments and Exchange Law made it clear that the tender offer requirements applies to the following:

- Purchases of the shares outside the financial instruments exchange and at the financial instruments exchange, which results in a rapid increase of shareholding of one-third or more of the total outstanding shares; and
- Purchases by a shareholder who holds more than one-third of the total outstanding shares, during the period of another tender offer made by another bidder.

A 'tender offer' means the purchase of shares outside the stock exchange market by offering to unspecified and many persons to purchase shares or by soliciting them to offer the sale of shares. To protect the investors and to maintain the order of the securities market, the Financial Instruments and Exchange Law provides for the procedures of a tender offer and disclosure requirement. To commence a tender offer, the tender offeror must publish in a daily newspaper or through EDINET (see text, below) a public notice setting forth such information as the purpose of the tender offer, the purchase price, number of shares to be purchased, and the tender offer period. The tender offeror also must file the registration statement of the tender offer with the Financial Services Agency.

An issuer of shares also may use a tender offer to purchase its shares. The above requirements relating to tender offers also are applicable to foreign issuers whose shares are listed on a stock exchange in Japan. They are generally not applicable to a foreign issuer if the tender offer is made only in the market outside of Japan.

Disclosure Relating to Substantial Shareholdings

The Financial Instruments and Exchange Law requires any person who has become, beneficially and solely or jointly, a holder of more than five per cent of the total issued shares of a company listed on any Japanese stock exchange or whose shares are traded on the over-the-counter market in Japan[17] to file a report concerning such shareholding with the Financial Services Agency within five business days.

A similar report also must be made in respect of any subsequent change of one per cent or more in any such holding. For this purpose, the shares issuable to such person on conversion of convertible securities or exercise of share subscription warrants are taken into account in determining both the number of shares held by such holder and the issuer's total issued share capital. Copies of each such report also must be furnished to the issuer of such shares and all Japanese financial instruments exchanges on which the shares are listed.

Disclosure Relating to Private Placement to Professional Investors

Under the Financial Instruments and Exchange Law, a private placement to professional investors can be made only if the issuer of the securities provides or discloses the information that is specified by the relevant Cabinet Office's Ordinance as information regarding the securities and the issuer to the professional investors by a means prescribed by the Cabinet Office's Ordinance.

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17 With the establishment of the JASDAQ Securities Exchange in December 2004, all shares registered with the Japan Securities Dealers Association for over-the-counter market trading were listed on the JASDAQ Securities Exchange.

In addition, the issuer of securities which are offered to or purchased by professional investors by way of a private placement to professional investors must periodically provide or disclose information as specified in the Cabinet Office's Ordinance.

Electronic Disclosure

In General

As of June 2001, the above-described disclosure may be made via internet. Though such electronic disclosure was permissible for only a few kinds of disclosure documents until May 2002, from June 2002 almost all disclosure documents other than reports concerning substantial shareholding can be disclosed using such electronic methods.

From June 2004, such an electronic disclosure will become a mandatory requirement for all kinds of disclosure documents except for some kinds of documents, such as reports concerning substantial shareholding and securities notices. This electronic disclosure system has been named the Electronic Disclosure Investors' Network, and is abbreviated as EDINET.

Companies Engaging in Financial Instruments Business

The Financial Instruments and Exchange Law has introduced the concept of financial instruments business, which includes securities business under the former Securities and Exchange Law. Financial instruments business consists of the first-tier financial instruments business, which is similar to the former securities business, the second-tier financial instruments business, the investment management business, and the investment advisory business. The first-tier financial instruments business includes:

- With regard to securities other than deemed securities, the business of buying and selling of such securities (dealer), acting as broker, intermediary, or agent in connection with transactions of such securities (broker), selling or distributing of such securities (distributor), and market derivative transactions on such securities (including acting as broker);
- Over-the-counter derivative transactions (including acting as broker);
- Underwriting of securities (underwriter);
- Proprietary trading system services; and
- Customer asset administration.

The second-tier financial instruments business includes:

- Self-offering (ie, primary public offering and private placement by the issuer itself) of limited kinds of securities;
- Acting as dealer, broker, or distributor on deemed securities, and market derivative transactions of deemed securities; and
- Non-securities market derivative transactions and foreign market derivative transactions.

Investment management business includes:

- Asset management of an investment trust or investment companies;
- Discretionary investment management business; and
- Asset management of a trust or collective investment scheme.

Investment advisory business includes:

- Investment advisory business; and
- Acting as a broker for the execution of investment advisory agreements.

Registration with the Prime Minister is required to conduct any kinds of these businesses, while specific requirements for registration, such as minimum capital requirements and net asset requirements, are different according to the kinds of the financial instruments business. The scope of business that can be conducted by registrants for the first-tier financial instruments business and the investment management business is restricted to financial instruments business and ancillary business, such as consulting business and money lending business, as specified by the Financial Instruments and Exchange Law.

Registrants may engage in other kinds of businesses when they obtain specific approval from the Financial Services Agency, although such approval may not be withheld unless the engagement by such registrants of the kind of the business in issue should be contrary to the public interest or deemed to be detrimental to protection of investors' interest. These restrictions on the scope of the business are not applicable to registrants for the second-tier financial business or those for the investment advisory business. The regulations on the financial instruments business generally apply to foreign firms in an identical manner. The Prime Minister is the competent authority to oversee the affairs of the financial instruments firms. Its authority to conduct investigation of business and assets of securities companies is delegated to the Financial Services Agency and the Securities and Exchange Surveillance Commission.

Financial Instruments Business by Banks. Under the Financial Instruments and Exchange Law, banks and other financial institutions are prohibited from engaging in financial instruments business, with limited exceptions, as was the case under the Securities and Exchange Law. Although this general prohibition still survives, the restrictions on financial institutions relating to the securities business have been relaxed in the past decade. Before such relaxation, the banks may, in principle, engage in securities business only with respect to public bonds (ie, national and local government bonds and bonds guaranteed by the government). The Financial System Reform Law and other subsequent changes have amended the Financial Instruments and Exchange Law to allow banks to engage in transactions involving beneficial certificates of investment trusts and investment certificates of investment companies and to enter into business involving over-the-counter securities derivative transactions. In addition, an amendment to the Financial Instruments and Exchange Law which became effective as of 1 December 2004 permited banks and other financial institutions to act as securities brokers for registered securities companies.

Furthermore, banks may set up a subsidiary which may engage in securities business. Previously, the scope of permitted activities of such subsidiaries in Japan did not include the underwriting, sale and purchase, or brokerage of equity securities (ie, shares), while they may engage in the business involving equity-like securities, such as convertible bonds and bonds with equity warrants. However, the restrictions on the securities business of such subsidiaries have been lifted.

Financial Instruments Exchanges. Currently, the financial instruments exchange consists of the stock exchange under the former Securities and Exchange Law and the financial futures exchange under the former Financial Futures and Exchange Law. There are six stock exchanges in Japan. The Tokyo Stock Exchange is by far the largest exchange in Japan in terms of number of listed companies and the annual trading volume of the listed stocks. The Osaka Securities Exchange is the second largest exchange in Japan. Although the trading volume of listed stocks effected on the Osaka Securities Exchange is not large as compared to that on the Tokyo Stock Exchange, the trading volume of the stock index futures and options effected on the Osaka Securities Exchange is larger than that on the Tokyo Stock Exchange since the NIKKEI Stock Index futures and options are traded on the Osaka Securities Exchange. Members or trading participants[18] of the stock exchanges are limited to registered financial instruments companies.

Currently, stocks of foreign companies are listed only on the Tokyo Stock Exchange or the Osaka Securities Exchange. Although the listing criteria applicable to foreign companies are not the same as those applicable to Japanese companies, the former is not more onerous than the latter.

Regulations Relating to Trading of Securities. The Financial Instruments and Exchange Law sets forth various provisions to ensure the fairness of the securities transactions. For example, the following provisions are stipulated:

- Prohibition of use of unlawful devices and schemes;
- Prohibition of circulation of rumours;
- Prohibition of market manipulation; and
- Insider trading regulations.

Violation of these provisions will constitute a criminal offence. In addition, an amendment to the Financial Instruments and Exchange Law which became effective as of 1 April 2005 introduced an administrative monetary penalty system. Under this system, the Prime Minister must impose a monetary penalty on violators of these provisions. Such monetary penalty is also applicable to cases where disclosure documents involving material misstatements are used in the public offering of securities. Furthermore, by

18 Until 2000, the Financial Instruments and Exchange Law required stock exchanges to be members of registered securities firms. This restriction has been relaxed and, currently, a stock exchange may be in the form of either a membership or a joint-stock company. Only the members (in the former case) or the trading participants (in the latter case) can trade securities directly at the relevant stock exchange.

amendment to the Financial Instruments and Exchange Law, effective 1 December 2005, such monetary penalty applies when continuous disclosure documents are filed with material misstatements. In addition, by amendment to the Financial Instruments and Exchange Law, effective in December 2008, such monetary penalty also applies to violations of the filing obligation for disclosure documents.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. Only the compenies engaging in the financial instruments business and registered under the Financial Instruments and Exchange Law may become members or trading participants of the stock exchanges in Japan. Some of the foreign securities firms are presently trading participants of the Tokyo Stock Exchange, the Osaka Securities Exchange, and the JASDAQ Securities Exchange.

Currently, the Tokyo Stock Exchange and the Osaka Securities Exchange admit the listing of shares of foreign companies. Set forth below is a brief explanation of some of the important listing criteria for listing of foreign stocks on the Tokyo Stock Exchange. The Tokyo Stock Exchange requires that foreign applicants meet the following criteria to be eligible to list their shares. More relaxed listing criteria may be applicable to certain venture companies.

Minimum Number of Shares Listed. Shares listed are likely to amount to the number corresponding to 4,000 or more trading units of such shares prior to the listing.

The trading unit is determined by the Tokyo Stock Exchange, such that the purchase price of the unit will not, in principle, exceed ¥500,000. The Tokyo Stock Exchange may change the trading unit for a listed foreign stock after taking into account the average per share price of the stock on the Tokyo Stock Exchange over a one-year period, the distribution of stock ownership in Japan, and other factors.

Number of Shareholders in Japan. The applicant must have at least 800 shareholders in Japan at or before the listing.

Share Distribution. A significant portion of shares may not be held by a limited number of shareholders. However, the Tokyo Stock Exchange criterion will be satisfied if the numbers of shares to be sold to the public will meet the listing criterion applicable to the listing of shares on a stock exchange of the applicant's home country.

Net Assets (Shareholders' Equity). The applicant must have net assets equivalent to ¥1 billion or more as of the end of the fiscal year ended immediately prior to the application for listing.

Profits. An applicant's profits in each of the last three consecutive years must satisfy the following requirements:

- Total over the last three years, ¥600 million or more;
- Most recent year, ¥400 million or more; and
- The third most-recent year, ¥100 million or more.

Otherwise, an applicant's profits in each of the last two years must satisfy the following requirements:

- Most recent year, ¥400 million or more; and
- Second most-recent year, ¥100 million.

Years Elapsed since Incorporation. The number of years elapsed since incorporation should be at least three calendar years as of the last day of the fiscal year immediately preceding the listing application date, and the applicant is required to have continuously conducted its business for the period.

Financial Statements. With respect to the consolidated and non-consolidated financial statements for each fiscal year ended during the last two (or three, as the case may be) calendar years, the independent certified public accountant issues an opinion that no false statements are included and issues, in principle, an unqualified fair opinion or an opinion expressly stating that useful information has been provided in financial statements for the latest full year and the first half of the latest year. Furthermore, there are no exceptional items in the opinion for the latest year and the first half of the last year.

Transborder Electronic Trading System. Transborder trading of securities by foreign securities firms is subject to the Financial Instruments and Exchange Law, whether or not an electronic trading system is used for the purpose of such trading. Under the Financial Instruments and Exchange Law, a foreign securities firm is defined as a person who is engaged in a securities-related business outside Japan in accordance with the laws of any country other than Japan. Under the Financial Instruments and Exchange Law, only foreign securities firms registered as financial instruments firms ('registered foreign securities firms') may, as a general matter, conduct related securities activities' ('securities activities') in Japan as a business.

In addition, the Financial Instruments and Exchange Law regulates, *inter alia*, the activities in Japan or directed toward Japan of foreign securities firms other than registered foreign securities firms ('unregistered foreign securities firms'). Pursuant to the Financial Instruments and Exchange Law, an unregistered foreign securities firm may not conduct securities activities directed toward persons in Japan except for certain securities activities enumerated in the Financial Instruments and Exchange Law. The following chart sets forth, by reference to the counterparty, the securities which an unregistered foreign securities firm may sell in Japan.

Counterparty and Securities Which May Be Sold in Japan by Unregisterd Foreign Securities Firm

Counterparty		*Securities*
The Government of Japan The Bank of Japan Registered securities firms Registered branches of foreign securities firm		No limitation
Investment trust management companies (for the account of the beneficiaries)		No limitation
Registered firms for the investment management business		No limitation
All Qualified Financial Institutions(1)	for the purpose of investment	No limitation
	for other purposes	National Government Bonds,(2) and Commercial Paper,(3) and so on
	Banks (for the account of their client and on written order)	No limitation
Certain Qualified Financial Institutions(1)	Long-term credit banks	Bonds issued under the Long-Term Credit Bank Law of Japan
	Trust banks	Beneficiary certificates issued under the Loan Trust Law of Japan

Notes to the Chart:

(1) 'Qualified Financial Institutions' includes: banks and life and non-life insurance companies.
(2) 'National Government Bonds' means: (a) national government bonds of any government; (b) local government bonds of any local governmental body in Japan; and (c) debentures guaranteed by a national government.
(3) 'Commercial Paper' includes: (a) commercial paper with a maturity of less than one year; and (b) certificates of deposit issued by a foreign juridical person with a maturity of less than one year.

In addition, an unregistered foreign securities firm acting as broker-dealer may execute transactions with a person in Japan who places an order with it unless that foreign securities firm does not solicit it. In this connection, it must be noted that the following activities are deemed to be comparable to the solicitation for that purpose:

- Advertisements regarding investment in securities by means of newspapers, magazines, television, radio, or other similar media (excluding those mainly directed toward people outside Japan);
- Holding of explanatory meetings regarding investment in securities;

- Providing information regarding investment in securities orally, in writing, or by means of telephone or other methods of communication; and
- Activities similar to those listed above.

If the transborder electronic trading system is to be used to trade securities with the persons in Japan, compliance with the provisions of the Financial Instruments and Exchange Law outlined above must be ensured.

Off-Market Transactions. The Japan Securities Dealers Association has promulgated regulations applicable to over-the-counter transactions involving the Japan Securities Dealers Association member firms. No different treatment is made among the member firms, whether they are Japanese securities companies or branches of registered foreign securities firms.

Securities

National Treatment and Reciprocity. The Financial Instruments and Exchange Law is applicable for foreign issuers, as well as Japanese domestic issuers. The applicability does not require reciprocity. Foreign countries and their local governments are subject to filing and disclosure requirements under the Financial Instruments and Exchange Law, although the Japanese government and Japanese local governments are not subject to such requirements.

Furthermore, a Cabinet Office's Ordinance exists setting the details of filing and disclosure requirements specific to sovereign issuers such as governments, local governments, governmental corporations, and international organisations. Under such Cabinet Office's Ordinance, various requirements under the Financial Instruments and Exchange Law are relaxed. As described in 'Exempted Securities' above, securities issued by certain international organisations are exempt from the public disclosure requirements under the Financial Instruments and Exchange Law.

Issuer Requirement. The Financial Instruments and Exchange Law itself does not impose any issuer requirements. Though there used to be a credit rating requirement established by ministerial guidance, in which only an issuer with at least a credit rating of the BBB or its equivalent was permitted to enter into the Japanese market, it no longer exists.

Securities Requirement. The Financial Instruments and Exchange Law defines 'securities' which are the subject of the Financial Instruments and Exchange Law, and does not impose any securities requirements. There were some securities requirements in the form of ministerial guidance with respect to commercial paper and certificates of deposit. Japanese dealers were obliged to offer commercial paper and certificates of deposit in accordance with the rules of the ministerial guidance. These requirements were abolished in June 1998.

With respect to foreign investment funds, there were securities requirements established by procedural guidelines of the Financial Services Agency of Japan. These requirements were also abolished.

Under the rules of the Japan Securities Dealers Association, in summary, the foreign securities which the Japan Securities Dealers Association member can deal with are limited. The Japan Securities Dealers Association rules also provide for the criteria for foreign investment trusts. Such criteria include:

- The foreign investment trusts were established in a country in which (a) a legal system for investment trusts has been well established, (b) a disclosure system for investment trusts has been well established, (c) there is an authority supervising issuers of investment trusts, and (d) purchase price, sales proceeds, and dividends can be transferred from or toward Japan;
- The net asset value of the trusts is ¥100 million or more;
- Japanese investors are entitled to take proceedings in Japanese courts in connection with the trusts;
- The trusts are prohibited from investing in more than 50 per cent of equity shares of a single company; and
- The financial statements of the trusts are audited by an independent accountant.

Prospectus Requirement. The same standard for Japanese domestic issuers is applicable to foreign issuers. In the case of public offerings and a certain specified offering, foreign issuers must prepare a Japanese-language prospectus in accordance with the Financial Instruments and Exchange Law.

Registration of Public Offerings. Basically, the treatment given to Japanese domestic issuers is applied also to foreign issuers. Form 7 is a form of a securities registration statement for a foreign corporate issuer. If the issuer is governed by laws of jurisdiction other than those of Japan, the legal system in the home country is required to be stated in Form 7. Furthermore, a legal opinion of local counsel as to the legality of the offering and the correctness of the legal matters stated in Form 7 is required. These requirements also apply to simplified securities registration statements.

As for sovereign issuers, the criteria for the eligibility for the simplified securities registration statement (ie, securities registration statement into which the issuer's information contained in the continuous disclosure document is incorporated by reference) and the shelf registration are relaxed. These include:

- The issuer files an annual securities report continuously for one year or more; and
- The issuer has already issued bonds in Japan and the aggregate nominal amount of the bonds is ¥10 billion or more; or
- A credit-rating agency designated by the Minister of Financial Services has assigned a qualified credit rating to one series of bonds issued by the issuer, and another such credit-rating agency has assigned a qualified credit rating to the same or a different series of bonds including those to be offered.

Registration of Placements. Except as described below, the same treatment given to Japanese domestic issuers is applied to foreign issuers. A legal opinion as to the laws of the home country is required to ascertain the legality of the placement. Under the Financial Instruments and Exchange Law, 'securities issued overseas' offered by way of a private placement are subject to certain resale restrictions. 'Securities issued overseas' means either securities which have already been issued outside Japan (except for securities for which a solicitation of an offer to buy was made in Japan at the time of issue) or securities which have already been issued in Japan but for which no solicitation of an offer to buy was made in Japan at the time of issue.

A notice must be given prior to the time of the purchase in respect of the resale restriction, ie, it must state that the owner may only transfer all the purchased securities to a single person, unless such transfer is made to non-residents of Japan. However, certain exceptions apply to the notice requirement. Specifically, notice is not required if:

- Disclosure with regard to the securities has already been made;
- The aggregate offer price of the securities is less than ¥100 million; or
- Certain conditions prescribed in the Cabinet Office's Ordinance are satisfied.

Appendix

(1) Continuous Disclosure

The descriptions below will focus on the requirements of the Financial Instruments and Exchange Law and of the Tokyo Stock Exchange.

(A) Disclosure under the Financial Instruments and Exchange Law

(a) Periodic Disclosures under the Financial Instruments and Exchange Law

Periodic disclosure required under the Financial Instruments and Exchange Law includes the following Reports.

a. Securities Report

Within three months (in the case of the foreign issuers, six months) after the end of each fiscal year, the issuer is required under the Financial Instruments and Exchange Law to file with the relevant financial authority three copies of a Securities Report in the Japanese language[19] for such year.[20]

b. Semi-Annual Report

Within three months after the end of the first six months of each fiscal year, the issuer without its securities being listed in any stock exchange in Japan is required under the Financial Instruments and Exchange Law to file with the relevant financial authority three copies of a Semi-Annual Report in the Japanese language[21] for such six-month period.[22]

c. Quarterly Report

Within 45 days (or 60 days for banks and insurance companies) after the end of each three-month period of each fiscal year, the issuer with securities being listed in any stock exchange in Japan is required under the Financial Instruments and Exchange Law to file with the relevant financial authority three copies of a quarterly report in the Japanese language.[23] for such three-month period.[24]

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19 With approval by the Financial Services Agency, the issuer may file English-written disclosure documents used in other jurisdictions, but English documents must be accompanied by Japanese materials supplementing some items.

20 Financial Instruments and Exchange Law, arts 24 and 25.

21 As of 1 December 2005, the Securities Reports and Semi-Annual Reports can be prepared in English in connection with limited types of securities.

22 Financial Instruments and Exchange Law, arts 24-5 and 25.

23 With approval by the Financial Services Agency, the issuer may file English-written disclosure documents used in other jurisdictions, but English documents must be accompanied by Japanese materials supplementing some items.

24 Financial Instruments and Exchange Law, art 24-4-7.

d. Parent Company Report

An amendment to the Financial Instruments and Exchange Law, effective 1 December 2005, introduced requirements for parent company reports. Under the amendment, a company not required to file the securities report, but shares of whose subsidiary are listed on a stock exchange or traded in the over-the-counter market in Japan, will be required to file with the relevant authority parent company reports in Japanese within three months from the end of its fiscal year.

(b) Extraordinary Reports

Under the Financial Instruments and Exchange Law, the issuer must file with the relevant financial authority three copies of a form called the Extraordinary Report on the occurrence of any one of the following events.[25]

a. A public offering of newly issued or outstanding securities, of which the issuer is the issuing company, having a total issue or sales price of not less than ¥100 million, is commenced outside Japan (please note that bonds and debentures, other than bonds with warrants (including convertible bonds), are excluded for the purposes of paragraph (a) and for paragraph (b), below; bonds with respect to which rights to purchase shares of stock are granted are deemed to be bonds with warrants for these purposes).

b. A resolution is approved by the board of directors of the issuer, or at a general meeting of shareholders of the issuer, authorising the issuance of securities, other than by means of a public offering, having a total issue price of not less than ¥100 million (or, if such an issue is to take place mainly outside Japan, such securities are actually issued).

c. A resolution is approved by the board of directors of the issuer, or at a general meeting of shareholders of the issuer, authorising an offering of share subscription warrants to directors and employees of the issuer that are exempt from the disclosure requirements, having a total issue price of not less than ¥100 million. For the purpose of share subscription warrants, the issue price means the sum of the offering price and the exercise price of such warrants.

d. Any change of a parent company (meaning cases where a company that has been a parent company of the issuer ceases to be such a parent company or where a company that has not been a parent company of the issuer becomes such a parent company) or any change of a specific subsidiary of the issuer (meaning cases where a company which has been a specific subsidiary of the issuer ceases to be such a subsidiary or where a company that has not been a specific subsidiary of the issuer becomes a specific subsidiary of the issuer). A specific subsidiary is defined as a subsidiary which satisfies any one of the following criteria:

(i) Total sales to, or the total purchases from, the issuer by such subsidiary equal to 10 per cent or more of the total purchases, or the total sales, respectively, of the issuer in the most recent business year;

25 Financial Instruments and Exchange Law, arts 24-5 and 25; Cabinet Office's Ordinance Concerning Disclosure of Contents of Companies, art 19.

(ii) Net assets of such subsidiary equal to 30 per cent or more of the net assets of the issuer as of the last day of the most recent business year; or

(iii) The capital of, or the aggregate amount of investment by the issuer in, such subsidiary equals 10 per cent or more of the capital of the issuer.

e. Any change of principal shareholders (meaning cases where a person who has been a principal shareholder of the issuer ceases to be a principal shareholder of the issuer or a person who has not been a principal shareholder of the issuer becomes a principal shareholder of the issuer).[26]

f. A material disaster. A material disaster shall mean a disaster with respect to which the book value of the assets damaged thereby amounts to not less than three per cent of the total book value of the net assets of the issuer and such damage can be considered as materially affecting the business of the issuer.

g. Litigation is initiated against the issuer in which damages are claimed in an amount equal to 15 per cent or more of the total amount of net assets of the issuer as of the last day of the most recent business year, or litigation against the issuer has been settled or otherwise concluded and the amount of damages payable in respect thereof is not less than three per cent of the net assets of the issuer as of the last day of the most recent business year.

h. An agreement of exchange of shares under which the issuer will be the sole parent company of the other company or the issuer will be a wholly owned subsidiary of the other company is concluded (including cases where the conclusion of such an agreement is expected with certainty and a public announcement to that effect has been made). In the former case, the other company must be either a company whose assets amounted to 30 per cent or more of the net assets of the issuer as of the last day of the most recent business year or a company whose total sales amounted to 10 per cent or more of the total sales of the issuer in the most recent business year. An exchange of shares means a corporate restructuring transaction under which equity shares of a company are mandatorily exchanged for the equity shares of another company, and the former thereby becomes a wholly-owned subsidiary of the latter.

i. A resolution is approved at a general meeting of shareholders of the issuer, authorising the establishment of a sole parent company through the exchange of shares.

j. An agreement of division of companies under which the issuer divides a portion of it or acquires a portion of another company is concluded, or a plan of such division is approved by the board of directors of the issuer or at its general meeting of shareholders, whereby it is estimated that the amount of assets of the issuer will be found to have increased or decreased by not less than 30 per cent of the net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenue of the issuer will be found to have increased or decreased by not less than 10 per cent of the total sales revenue

26 A 'principal shareholder' is defined as a shareholder who holds not less than 10 per cent of the total number of issued voting shares in such shareholder's own name or in the name of other persons (including fictitious persons); provided, however, pursuant to the relevant Cabinet Office's Ordinance, the shares held either by trust corporations as trust property or by securities companies as a result of their underwriting or selling business are not counted in the shares held for the purpose of determining share ownership.

of the issuer in the most recent business year (including the case where the conclusion of such an agreement or the approval of such a plan, as the case may be, is expected with certainty and a public announcement to that effect has been made).

k. An agreement of statutory merger is concluded whereby it is estimated that the amount of assets of the issuer will increase or decrease by not less than 30 per cent of the net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenue of the issuer will increase or decrease by not less than 10 per cent of the total sales revenues of the issuer in the most recent business year, or whereby the issuer will be dissolved (including the case where the conclusion of such an agreement is expected with certainty and a public announcement to that effect has been made).

l. An agreement for an assignment or acquisition of business is concluded whereby it is estimated that the amount of assets of the issuer will increase or decrease by 30 per cent or more of the net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenues of the issuer will increase or decrease by 10 per cent or more of the total sales revenues of the issuer in the most recent business year (including the case where the conclusion of such an agreement is expected with certainty and a public announcement to that effect has been made).

m. Any change in the representative directors (meaning cases where a person who has been a representative director of the issuer ceases to be a representative director or a person who has not been a representative director becomes a representative director, but excluding the case where such a change has taken place within the period from the closing of an annual general meeting of shareholders of the issuer to the filing of a Securities Report and the substance of the change is stated in the Securities Report). A representative director is a director of a Japanese corporation under Japanese law who is duly authorised to represent such corporation without any specific authorisation.

n. An application for bankruptcy under the Bankruptcy Law, commencement of reorganisation procedures under the Corporate Reorganisation Law, or other similar bankruptcy proceedings is made in respect of the issuer.

o. Any bill or check is dishonoured by, or an application for the commencement of any bankruptcy proceedings is made by or against, or any event similar thereto occurs with respect to, any person who owes any debt to, or has been granted any guarantee on any of its debt by, the issuer (in this paragraph a ‘debtor‘) whereby any impossibility or delay in collection of receivables, advances, or any other credit against such debtor is threatened to occur in an amount not less than three per cent of the net assets of the issuer as of the last day of the most recent business year.

p. Any event materially affecting the financial condition and business results of the issuer occurs. An event materially affecting the financial condition and business results of the issuer means any event which occurs after the date as of which the latest balance sheet is prepared and which will have a material effect on the financial condition and business results of the issuer in subsequent business years. The financial effect of such an event on the issuer must be not less than three per cent of the net assets of the issuer as of the last day of the most recent business year and not less than 20 per cent of the average net profits of the issuer for the last five business years.

q. A material disaster to a consolidated subsidiary of the issuer. A material disaster to a consolidated subsidiary of the issuer shall mean a disaster with respect to which the book value of the assets of the subsidiary damaged thereby amounts to not less than three per cent of the total book value of the consolidated net assets of the issuer and such damage can be considered as materially affecting the business of the issuer.

r. Litigation is initiated against a consolidated subsidiary of the issuer in which damages are claimed in an amount equal to 15 per cent or more of the total amount of the consolidated net assets of the issuer as of the last day of the most recent business year, or litigation against a consolidated subsidiary of the issuer has been settled or otherwise concluded and the amount of damages payable in respect thereof is not less than three per cent of the consolidated net assets of the issuer as of the last day of the most recent business year.

s. An agreement of exchange of shares involving a consolidated subsidiary of the issuer is concluded, whereby it is estimated that the amount of assets of the issuer will be found to have increased or decreased by not less than 30 per cent of the consolidated net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenue of the issuer will be found to have increased or decreased by not less than 10 per cent of the total sales revenue of the issuer in the most recent business year (including cases where the conclusion of such an agreement is expected with certainty and a public announcement to that effect has been made).

t. A resolution is approved at a general meeting of shareholders of a consolidated subsidiary of the issuer, authorising the establishment of a sole parent company of such a subsidiary through exchange of shares, whereby it is estimated that the amount of assets of the issuer will be found to have increased or decreased by not less than 30 per cent of the consolidated net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenue of the issuer will be found to have increased or decreased by not less than 10 per cent of the total sales revenue of the issuer in the most recent business year.

u. An agreement of division of a company under which a consolidated subsidiary of the issuer divides a portion of it into another entity or acquires a portion of another company is concluded, or a plan of such division is approved by the board of directors of that subsidiary or at its general meeting of shareholders, whereby it is estimated that the amount of assets of the issuer will be found to have increased or decreased by not less than 30 per cent of the consolidated net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenue of the issuer will be found to have increased or decreased by not less than 10 per cent of the total sales revenue of the issuer in the most recent business year (including cases where the conclusion of such an agreement or the approval of such a plan, as the case may be, is expected with certainty and a public announcement to that effect has been made).

v. An agreement of statutory merger involving a consolidated subsidiary of the issuer is concluded whereby it is estimated that the amount of assets of the issuer will increase or decrease by not less than 30 per cent of the consolidated net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenue of the issuer will increase or decrease by not less than 10 per cent of the total sales revenues of

the issuer in the most recent business year, or whereby the consolidated subsidiary will be dissolved (including the case where the conclusion of such an agreement is expected with certainty and a public announcement to that effect has been made).

w. An agreement for an assignment or acquisition of business of a consolidated subsidiary of the issuer is concluded whereby it is estimated that the amount of the assets of the issuer will increase or decrease by 30 per cent or more of the consolidated net assets of the issuer as of the last day of the most recent business year or it is estimated that the total sales revenues of the issuer will increase or decrease by 10 per cent or more of the total sales revenues of the issuer in the most recent business year (including the case where the conclusion of such an agreement is expected with certainty and a public announcement to that effect has been made).

x. An application for bankruptcy, commencement of reorganisation, or similar bankruptcy proceedings is made in respect of a consolidated subsidiary of the issuer, and the net assets of such subsidiary or the amount by which the total debt of such subsidiary exceeds the total assets of such subsidiary is three per cent or more of the consolidated net assets of the issuer.

y. Any bill or check is dishonoured by, or an application for the commencement of any bankruptcy proceedings is made by or against, or any event similar thereto occurs with respect to, any person who owes any debt to, or has been granted any guarantee on any of its debt by, a consolidated subsidiary of the issuer (in this paragraph, a 'debtor') whereby any impossibility or delay in collection of receivables, advances, or any other credit against such debtor is threatened to occur in an amount not less than three per cent of the consolidated net assets of the issuer as of the last day of the most recent business year.

z. Any event materially affecting the consolidated financial condition and consolidated business results of the issuer occurs. An event materially affecting the financial condition and business results of the issuer means any event that occurs after the date as of which the latest consolidated balance sheet is prepared which will have a material effect on the financial condition and business results of the issuer in subsequent business years. The financial effect of such an event on the issuer must be not less than three per cent of the consolidated net assets of the issuer as of the last day of the most recent business year and not less than 20 per cent of the average net profits of the issuer in the consolidated financial statements for the last five business years.

(2) Mandatory Procedures under the Tokyo Stock Exchange Rules

(A) Ordinary Procedures

The Tokyo Stock Exchange Rules require the issuer to follow certain procedures, including notifications to the Tokyo Stock Exchange and, in certain instances, to the shareholders and the public.

(a) Shareholders' Meeting

In connection with the convocation and holding of the annual shareholders' meeting (these requirements also are applicable to an extraordinary meeting), the issuer must take certain measures to enable beneficial shareholders to exercise their voting rights.

a. Notice of Record Date of Shareholders' Meeting:

On the adoption of a resolution fixing a record date for a shareholders' meeting, the issuer should notify the Tokyo Stock Exchange and the Agent of such resolution at least two weeks before the record date. The issuer must, in general, provide public notice of the record date in a daily newspaper in the Japanese language at the same moment. However, the issuer is exempt from this public notice requirement so long as the documents necessary for exercising the voting rights are delivered to beneficial shareholders as described in b., below. Therefore, virtually no foreign issuers provide this public notice.

b. Proxy Statement Materials:

In order that the voting rights of shareholders in Japan may be properly exercised, the issuer must provide the Agent with the necessary documents for exercising the voting rights, such as a proxy statement in the Japanese language. Simultaneously, a copy of each of the documents in the original and Japanese (and English, if available) languages must be submitted to the Tokyo Stock Exchange.

(b) Dividend Payment Procedures

On adoption of a resolution fixing the record date for dividend payment, the issuer must notify the Tokyo Stock Exchange and the Agent thereof at least two weeks before such record date.

(c) Brief Notice Regarding a Settlement of Accounts

a. Brief Notice of Annual Accounts Settlement:

The issuer must file with the Tokyo Stock Exchange a Brief Notice of Annual Settlement of Accounts in the Japanese language on the release thereof to the press in its home country and elsewhere. This Brief Notice also must be distributed to the Japanese press.

b. Brief Notice of Interim Accounts Settlement:

The issuer also must file with the Tokyo Stock Exchange a Brief Notice of Interim Settlement of Accounts in the Japanese language on the release thereof to the press in its home country and elsewhere. This Brief Notice also must be distributed to the Japanese press.

(d) Report Concerning the Number of Listed Shares

The issuer must file with the Tokyo Stock Exchange a Report of Status of Conversion of Securities and Issuance of New Shares, etc. soon after the commencement of each fiscal year. This report is used to calculate the annual listing fee. This report relates only to newly issued shares which are already covered by previous listing applications, and if the issuer issues new shares which are not covered by the previous applications (such as new shares issued under a public offering or newly established stock option plan), the issuer must file another listing application to list such new shares.

(e) Documents Filed with the Competent Authorities in Other Jurisdictions

The issuer must file with the Tokyo Stock Exchange a copy of each of the documents filed with the competent authorities in its home country and elsewhere (including the Securities and Exchange Commission of the United States) on the filing thereof (for example, Form 10-K).

(f) Annual Report to Shareholders

The issuer must distribute to shareholders in Japan, Japanese language versions (a summarised version is acceptable under the applicable Tokyo Stock Exchange rule) of business reports (including annual and semi-annual reports, if any) at the same time as such reports are distributed to shareholders in the home country and/or other jurisdiction; provided, however, that a listed foreign issuer is not required to prepare for delivery to its shareholders in Japan a Japanese language version of its annual report. A listed foreign issuer, instead, is required to deliver to its shareholders either: (i) information derived from the 'Changes in Major Business Indices', 'Description of Operations', 'Financial Statements', and 'Auditors' Report' sections of the Securities Report referred to above, or (ii) information derived from the 'Description of Operations' and 'Financial Statements' in the Securities Report, together with the English version of the annual report. Even in cases where the issuer prepares a semi-annual or quarterly report, the issuer is allowed to distribute the Brief Notice of Interim-Annual Accounts Settlement referred to above in lieu of the Japanese version of the semi-annual or quarterly report under the relevant Tokyo Stock Exchange rules so long as such Brief Notice contains certain information required under the Tokyo Stock Exchange rule.

(g) Other Documents

In addition to the foregoing, the issuer is, in principle, required to submit to the Tokyo Stock Exchange all documents which will be distributed to its shareholders before such distribution.

(B) Special Procedures

(a) Issuance of Securities

a. Issuance of New Shares

If the issuer issues additional ordinary shares, the issuer must file with the Tokyo Stock Exchange an Amendment Application for listed securities on each occasion unless the shares so issued have been already covered by previous listing applications.

(i) Public Offering of New Shares outside Japan. On the adoption of a resolution authorising a public offering of new shares outside Japan, the issuer must file with the Tokyo Stock Exchange a further application for listed securities describing the contents of such resolution. If the offering is made in the home country and/or other jurisdiction, and a registration statement is filed with the competent authorities in such country, a copy of such registration statement also must be submitted to the Tokyo Stock Exchange. The issuer also is required to file an Extraordinary Report as described above.

(ii) Public Offering of New Shares in Japan. On the adoption of a resolution authorising a public offering of new shares in Japan, the issuer must file with the Tokyo Stock Exchange a further application for listed securities describing the contents of such resolution. Furthermore, the issuer is required to file a Securities Registration Statement with the relevant financial authority under the Financial Instruments and Exchange Law and to follow various procedures under the Financial Instruments and Exchange Law, the regulations of the Tokyo Stock Exchange, and other relevant regulations. Under the Financial Instruments and Exchange Law, an offering of shares in a listed company always constitutes a public offering. However, an issuance of shares to any shareholders which does not involve any offering to the shareholders (such as a stock split or stock dividends) does not constitute a public offering.

(iii) Private Placement of New Shares. On the adoption of a resolution authorising a private placement of new shares both within and outside Japan, the issuer must file with the Tokyo Stock Exchange a further application for listed securities describing the contents of such resolution. The issuer also is required to file with the relevant financial authority an Extraordinary Report as described above.

(iv) Stock Dividend, Stock Split, and Consolidation of Shares. On the adoption of a resolution authorising a stock dividend, a stock split, or a consolidation of shares, the issuer must file with the Tokyo Stock Exchange a notice thereof. In addition, public notice of the record date must be made in a daily newspaper. The issuer also must file with the relevant financial authority an Extraordinary Report, as described above.

b. Stock Option Plan

On the adoption of a new stock option plan, the issuer must file with the Tokyo Stock Exchange a further application for listed securities.

c. Other Securities Issuances

On the adoption of a resolution authorising the issuance of convertible debentures which may be converted into ordinary shares of the issuer, or on offering stock subscription or purchase rights under which ordinary shares will be issued, the issuer must file with the Tokyo Stock Exchange a further application concerning the ordinary shares of the issuer. In addition, the issuer may be required to file with the relevant financial authority an Extraordinary Report as described above. If securities of the issuer are offered or sold in Japan or to Japanese residents, the issuer also may be required to follow various procedures under the Financial Instruments and Exchange Law and other relevant regulations.

(b) Notice to Tokyo Stock Exchange

In addition to the foregoing, pursuant to the relevant regulations of the Tokyo Stock Exchange, a listed issuer must promptly submit to the Tokyo Stock Exchange the

following notices and reports when relevant (this information also must be distributed to the Japanese press):[27]

a. Material Corporate Information Regarding Management Decisions, including but not limited to:

(i) Issuance of Shares, Bonds with Warrants (including Convertible Bonds), or Warrants

(ii) Reduction of Capital, or Legal Reserve

(iii) Acquisition of Treasury Shares and Disposition of such Treasury Shares

(iv) Stock Split or Stock Consolidation

(v) Payment of Dividends

(vi) Merger or Transfer or Exchange of Shares (including establishment of a sole parent company)

(vii) Division of the Issuer

(viii) Transfer or Acquisition of All or a Part of a Business

(ix) Dissolution

(x) Commercialisation of a New Product or a New Technology

(xi) Entering into Business Affiliation, or the Termination of a Business Affiliation

(xii) Transfer or Acquisition of Shares or an Equity Interest Accompanied by a Change in the Composition of the Issuer's Subsidiaries

(xiii) Transfer, Acquisition, or Lease of Fixed Assets

(xiv) Suspension or Discontinuation of All or a Part of Issuer's Business

(xv) Application for De-listing from a Stock Exchange in Japan or Foreign Countries

(xvi) Petition for Bankruptcy, Revival Procedure, or Corporate Reorganisation

(xvii) Starting-up of a New Business

(xviii) Tender Offer or a Release of Opinion Regarding Tender Offer

(xix) Change of Representative Director

(xx) Corporate Restructuring such as Reduction in the Number of Employees by Layoff

(xxi) Change, Establishment, or Abolishment of Trading Unit of Shares

(xxii) Change of Issuer Name

(xxiii) Change of Accounting Period

(xxiv) Grant of Stock Option to Officers or Employees including Issuance of Stock Acquisition Rights to Them

27 The items that would be applicable only to Japanese domestic companies have been omitted from the following lists. As to the items described in paragraphs a., b., and c., below, the Tokyo Stock Exchange generally requires that it be notified of the corresponding items relating to a subsidiary of a listed issuer as well, subject to the materiality requirement stipulated in the Tokyo Stock Exchange rules.

(xxv) Redemption of All or a Part of Listed Bonds, Convocation of Bondholders' Meeting for Listed Bonds, and Other Material Matters Relating to Rights of Holders of Listed Bonds

(xxvi) Change of Auditor of a Listed Issuer

(xxiv) Any Other Event Having a Material Impact on the Issuer's Corporate Management, Financial Status, Business Results, Listed Securities or anything that Would Affect the Investment Decisions of Investors

b. Material Corporate Information on the Occurrence of Certain Events, including but not limited to:

(i) Damage Resulting from Natural Disaster, or Arising during Normal Business Operations

(ii) Change in One of the Major Shareholders

(iii) De-listing of Certain Securities

(iv) Commencement of a Lawsuit, Rendering of a Court Judgment or Settlement

(v) Petition for a Preliminary Injunction for Suspension of Business and the like or Rendering of a Court Decision or Settlement on Such Petition

(vi) Cancellation of Licence, Suspension of Business, or any Other Disciplinary Action Taken by an Administrative Agency or an Action Taken by an Administrative Agency Based on a Violation of Law or Regulation

(vii) Change in the Identity of the Parent Company

(viii) Petition for, or Notification of, the Commencement of Bankruptcy, Revival Procedure, Corporate Reorganisation, Winding-Up, or Foreclosure of Enterprise Mortgage by Creditors

(ix) Dishonour of a Negotiable Instrument, such as Promissory Note or Check, or the Suspension of Transactions by a Clearing House

(x) Petition for Bankruptcy or the Like with respect to the Parent Company

(xi) Default of a Debtor, or Delay in the Collection of Debts

(xii) Cessation of the Business Relationship with a Major Customer or a Supplier

(xiii) Financial Support by Creditors, such as the Discharge of an Indebtedness

(xiv) Discovery of Natural Resources

(xv) Petition by Shareholders for Injunction Suspending Issuance of New Shares or Stock Acquisition Rights (including Bonds with Stock Acquisition Rights)

(xvi) Request by Shareholders to Convene Shareholders' Meeting

(xvii) Unrealised Losses regarding Securities

(xviii) Occurrence of an Event of Default for Listed Bonds, Convocation of Bondholders' Meeting for Listed Bonds, and Other Material Events Relating to Rights of Holders of Listed Bonds

(xix) Change of Auditor of a Listed Issuer

(xx) Failure of Filing a Securities Report or a Semi-Annual Report

(xxi) Disapproval by Creditors of a Plan of Reorganisation under a Non-Judicial Reorganisation Negotiation

(xxii) Occurrence of any other Event Having a Material Impact on the Issuers, Issuer Corporate Management, Financial Status, Business Results, Listed Securities, or Anything that Would Affect the Investment Decisions of Investors

c. Material Corporate Information Concerning Account Statements, including but not limited to:

(i) Account Statements

(ii) Correction of a Projection concerning Business Operations

(iii) Correction of a Projection concerning Dividends

d. Other Information on Listed Foreign Companies, including but not limited to:

(i) Changes in the Laws regarding the Corporate System in the Home Country

(ii) Material Facts Affecting Negotiability or Distribution of Shares of a Listed Issuer, such as Delisting from the Stock Exchange in the Home Country

Generally, the Tokyo Stock Exchange takes the position that shareholders in Japan should have the same access to information regarding the issuer as shareholders in the home country of the issuer and elsewhere. Accordingly, it is recommended that all information released to the press in the home country or in any other country by the issuer be sent to the Tokyo Stock Exchange and, if the Tokyo Stock Exchange believes it is important, to the Japanese press. In addition to the disclosures and procedures described above, the Tokyo Stock Exchange may, from time to time, request that the issuer provide the Tokyo Stock Exchange with specific information requested by it as it is empowered to do under the relevant regulations.

(c) Disclosure of Information regarding a Parent Company

If a listed issuer is a subsidiary or an affiliate of another company (the 'Parent Company'), such listed issuer must disclose, together with its annual accounting settlement, certain information about the Parent Company, etc., such as corporate name, percentage of voting rights in the issuer held by the Parent Company, and name of stock exchange where shares of the Parent Company are listed. In addition, if the Parent Company is not listed on any stock exchange inside or outside Japan and in other particular cases, the listed issuer must disclose account settlement and material information regarding certain management decisions and occurrence of certain events regarding the Parent Company.

(d) Written Confirmation regarding Appropriateness and Accuracy of Securities Report and Semi-Annual Report

When a listed issuer files a Securities Report or Semi-Annual Report, it must submit to the Tokyo Stock Exchange without delay a document stating that the representative thereof acknowledges that there are no false statements in such securities report or semi-annual report at the time of filing, and explaining his basis for such statement. This document shall be available for public inspection as well as other disclosure documents filed with the Tokyo Stock Exchange.

Latvia

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Latvia

Mārtiņš Rudzītis
SORAINEN
Rīga, Latvia

Introduction

Regulatory System

The Latvian regulatory model of capital markets relies on the combination of governmental regulation and self-regulation. While the government remains the primary regulator in Latvia, it strongly relies on Nasdaq OMX Riga, a regulated market organizer, to exercise certain regulatory and surveillance powers in relation to market operation. The advantages of this model are apparent: self-regulation brings additional expertise and resources to the government in raising the standards of conduct and ensures closer supervision of the market participants.

Legal Sources

The following sources of Latvian securities law may be distinguished:

- Directly applicable European Union (EU) financial market regulations;
- Laws and regulations adopted under delegated legislation mandate;
- Regulations adopted by the Financial and Capital Market Commission (binding to the financial market participants); and
- Nasdaq OMX Riga and Latvian Central Depository self-regulations (binding to the member of the relevant entities and issuers of securities).

The Latvian statutory framework of securities markets has been largely harmonized with European law, in particular the Prospectus Directive,[1] the Transparency Directive,[2] the Market Abuse Directive, and the Markets in Financial Instruments Directive.[3]

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1 Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

2 Directive 2004/109/EC of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

3 Directive 2004/39/EC of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the

The Financial Instruments Market Law is the main source of securities law in Latvia that regulates provision of financial services and ancillary (non-core) services, public offering, listing and admission to trading of financial instruments, and rights and obligations of participants of the financial instruments market.

The Financial Instruments Market Law provisions under the delegated powers are further detailed in the Financial and Capital Market Commission regulations, in particular regulations on contents and procedures for preparing a prospectus and admission of securities to trading on a regulated market. Corporate law aspects of issuing shares and corporate bonds are regulated by the Commercial Law and the Groups of Companies Law. Special provisions on issuing of mortgage bonds are provided in the Law on Mortgage Bonds.

Furthermore, brokerage companies and credit institutions providing investment services in respect of the financial instruments registered with the Latvian Central Depository and traded on a regulated market in Latvia are subject to the Latvian Central Depository regulations on holding, registering, clearing, and settling financial instruments and Nasdaq OMX Riga regulations on listing and trading of securities. The legal regime applicable to investment services applies to financial instruments that are defined in line with the Markets in Financial Instruments Directive, notably:

- Transferable securities, being shares and other transferable securities equivalent to shares that ensure a holding in the capital of a company, bonds and other debt securities, other marketable transferable securities whereto the right to acquire the shares or bonds by subscription or exchange are attached, and share certificates;
- Units of investment funds and other transferable securities that certify a holding in investment funds or collective investment undertakings similar to investment funds;
- Money-market instruments;
- Certain derivatives; and
- Structured financial instruments.[4]

Authorities

Financial and Capital Market Commission

The Financial and Capital Market Commission is the regulatory and supervisory authority of the financial markets in Latvia vested with the task of protecting the

European Parliament and of the Council and repealing Council Directive 93/22/EEC that will be replaced by Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) by 3 July 2016.

4 Markets in Financial Instruments Directive, Annex I, s C; Financial Instruments Market Law, art 3(2).

interests of investors, depositors, and the insured, and of promoting the development and stability of the financial and capital market. In doing so, the Financial and Capital Market Commission has authority to:

- Issue regulations and directives, governing activities of financial and capital market participants;
- Request and receive information from financial and capital market participants, as well as from other public institutions for execution of its functions;
- Impose restrictions on the activities of financial market participants, to ensure compliance with the financial regulation, and to penalize infringements of the financial regulations; and
- Cooperate and exchange information with foreign financial and capital market supervision authorities and carry out other activities prescribed by the law.[5]

Latvian Central Depository

The Latvian Central Depository is a subsidiary of Nasdaq OMX Riga. The Latvian Central Depository maintains accounts for, and book entries of, the financial instruments that are publicly held in Latvia and ensures settlement of financial instruments and cash in transactions on the regulated market, as well as settlement of financial instruments among custodians.

The Latvian Central Depository allows the custodians to hold financial instruments in a dematerialized form, and the rights to securities are evidenced with a book entry in the financial instruments account (shares in a publicly held company need to be in bearer and dematerialized form).

Nasdaq OMX Riga

Nasdaq OMX Riga is the only licensed market organizer in Latvia that operates two market segments: the regulated market and the First North. The market organizer is authorized to issue regulations to market participants and to supervise the issuers of financial instruments listed and admitted to trading on the regulated market.

Procedures

The Financial and Capital Market Commission is empowered, among others, to issue regulations under the delegated legislation powers, license, and supervise financial institutions. The Financial and Capital Market Commission adopts administrative acts according to generally applicable administrative procedure, subject to any exceptions prescribed by the Financial Instruments Market Law.

5 Law on the Financial and Capital Markets Comission, art 7.

In particular, the Financial and Capital Market Commission is responsible for vetting and registration of the prospectuses, licensing of financial market participants, and ensuring protection of depositors and investors. The Financial and Capital Market Commission is authorized to impose penalties for the violations of the financial markets laws (eg, operating without a license, failure to notify acquisition of substantial participation, insider trading, and market manipulation). Procedures for listing and admission of financial instruments to trading are set out in the Nasdaq OMX Riga regulations.

Legal Order and Regulatory Interests with Special Regard to Foreign Elements

Admission

Market Participants

Domestic Exchanges. Nasdaq OMX Riga is the only licensed organizer of a regulated market in Latvia that has extensive self-regulatory powers that may be exercised under the supervisory umbrella of the Financial and Capital Market Commission. Nasdaq OMX Riga is authorized to adopt binding regulations to its members and issuers and to supervise the operation of a regulated market.[6]

In particular, Nasdaq OMX Riga has issued regulations on listing, admission, and trading of financial instruments on the regulated market, settlement of financial instruments and cash, and identification and prevention of market manipulation. NASDAQ OMX Riga operates two market segments that are calibrated according to the regulatory requirements and the market needs: the regulated market (stock exchange) and the Baltic alternative market First North (multilateral trading system).

The regulated market segment targets large and well-established companies seeking access to capital markets. The issuers whose securities are included in the official list of, or admitted to trading on, the regulated market are subject to full scope of the EU regulatory and disclosure requirements.

First North is a second-tier alternative market specifically designed for fast-growing, developing companies that seek to access capital markets. First North is harmonized across the Nasdaq OMX exchanges in Tallinn, Riga, and Vilnius and utilizes the Nasdaq OMX trading, information, and distribution infrastructure, but as a multilateral trading facility has lower regulatory demands and admission requirements. There are no quantitative requirements for the admission of securities to First North.

Admission to trading on First North falls outside the mandatory EU disclosure regime, unless there is a public offering of the securities. There is no pre-vetting of admission documents by Nasdaq OMX Riga. Instead, the First

6 Financial Instruments Market Law, art 28.

North Rules[7] require that companies applying to join First North appoint a certified adviser that is affiliated with First North and to retain at all times afterwards the admission to the market. It is the responsibility of a certified advisor to warrant that the applicant is appropriate for First North and advise the company about its obligations to ensure compliance on an ongoing basis with the First North Rules.[8]

Transborder Electronic Trading Systems. Nasdaq OMX Baltic market includes common Baltic securities lists, common and harmonized indexes, and access for investors to all Baltic listed financial instruments through any of the pan-Baltic members. NASDAQ OMX Baltic exchanges employ two trading systems:

- INET Nordic for trading in instruments in the equities market; and
- Genium INET for trading in instruments in the fixed-income market and for auctions and special procedures (tender offer, public share sale, and initial public offering) execution.[9]

Trading facilities of Nasdaq OMX Riga are accessible to authorized members of the market organizer, ie, brokerage companies and credit institutions entitled to provide investment services in Latvia and other EU/EEA member states that fulfill other statutory and Nasdaq OMX requirements. Nasdaq OMX may allow the State Treasury, the Bank of Latvia, and similar foreign institutions to accede a specific market segment without becoming a member of Nasdaq OMX. Orders are accepted from a broker who is authorized by Nasdaq OMX Riga and mandated by its member.

The transactions in financial instruments registered with the Latvian Central Depository are cleared and settled on delivery versus payment basis. Latvian Central Depository has established corresponding relationships with Estonian Central Securities Depository, Lithuanian Central Securities Depository, and Clearstream Banking Luxembourg, allowing Latvian Central Depository participants to act as custodians with regard to the financial instruments registered with a counterpart depository.

In the absence of a corresponding relationship between Latvian Central Depository and foreign central securities depositories, the issuers need to use depository receipts in order to cross-list on a foreign stock exchange (eg, a Latvian company seeking admission of shares registered with the Latvian Central Depository to trading on the London Stock Exchange might need to use depository receipts or CREST depository interest for settlement purposes).

7 Nasdaq OMX Riga Regulation on the Baltic Alternative Market First North (lastly amended on 18 December 2014) (the 'First North Rules').
8 First North Rules, s 15.
9 See http://www.nasdaqomxbaltic.com/en/.

Off-Market Transactions. The Latvian Central Depository clearing and settlement rules apply also to over-the-counter transactions in financial instruments registered with the Latvian Central Depository or central securities depositories having corresponding relationships with the Latvian Central Depository. Over-the-counter transactions are settled on gross basis (delivery versus payment).

Securities

National Treatment and Reciprocity. As a general rule, foreign issuers are subject to the listing and admission requirements set out in the Financial Instruments Market Law and the Nasdaq Listing Rules.[10] Limited mutual recognition has been achieved at the EU level through harmonization of mandatory prospectus disclosure requirements. In particular, the EU issuers benefit from a 'single passport' under which they may rely on a prospectus approved by the competent authority of the home state without registration of a prospectus with the Financial and Capital Market Commission.

In order to passport a prospectus to Latvia, an issuer must apply to the competent authority of his home member state for regulatory approval of the prospectus before it is published. Once a prospectus is approved it has EU-wide scope which means that is valid for pubic offers or admission of securities to trading on a regulated market in Latvia. The home state must inform the Financial and Capital Market Commission and the European Securities Market Authority that the prospectus has been approved in accordance with the Prospectus Directive and send a copy of the prospectus. Despite the EU 'single passport' regime, there has not been considerable activity from the part of Latvian issuers in taking in more liquid capital markets through international public offerings or cross-listing on foreign exchanges.

Official List. The requirements for the admission of shares, bonds, and other securities to an official list are set out in the Financial Instruments Market Law and the Nasdaq Listing Rules. Nasdaq OMX Riga is the Latvian listing authority, thus, listing and admission of securities to trading on the regulated market are viewed as being part of a single screening process.

Nasdaq OMX Riga operates different listing categories that are calibrated according to the market needs and regulatory requirements.[11] The primary listing is a market segment for shares and other equities of blue-chip companies subject to higher eligibility requirements. The second listing is a market segment with a lighter-version regime for smaller and younger companies with shorter business record and lower market capitalization requirements. In addition, Nasdaq OMX Riga maintains a special list for debt securities and investment fund units.

10 Nasdaq OMX Riga Rules on Financial Instruments Admission to and Listing on the Regulated Markets (the 'Nasdaq Listing Rules').

11 Nasdaq Listing Rules, s 2.4.

Issuer Requirements. Nasdaq OMX Riga regulations provide for the following issuer eligibility requirements:

- The issuer must be registered and operates according to the law of the state of registration, articles of association, and Nasdaq OMX Riga regulations;
- The issuer's articles of association comply with the respective laws and are publicly available;
- Nasdaq OMX Riga may reject admission of the financial instruments to the official list if the issuer is subject to legal protection proceedings (*tiesiskās aizsardzības process*), out-of-court legal protection proceedings (*ārpustiesas tiesiskās aizsardzības process*), insolvency proceedings, or the issuer has had solvency problems within two years prior to applying for listing; and
- The issuer's business activities do not harm the interests of investors.[12]

Nasdaq OMX Riga has considerable discretion in listing matters, in particular it may refuse to include financial instruments in the official list if the issuer and the financial instruments comply with the formal eligibility requirements, but listing would negatively impact smooth functioning of the regulated market and prejudice the investor's interests.

Nasdaq OMX Riga decides on listing having regard to the issuer's financial standing, market position, client structure, growth potential, business activity, reputation, future plans, and other criteria that are material for assessment of the issuer's business activity.[13]

Securities Requirements. Nasdaq Listing Rules provide for the following general listing requirements:

- The financial instruments are freely transferable and the issuer's articles of association do not restrict the right to alienate financial instruments (eg, pre-emption rights);
- The financial instruments are in a dematerialized form and registered with the Latvian Central Depository or in any other foreign central securities depository with whom Nasdaq OMX Riga and/or the Latvian Central Depository has an agreement on settlement of trades;
- The financial instruments are issued in accordance with the applicable laws and the issuer's articles of association and other regulations;[14] and
- The market for the respective financial instruments is sufficiently liquid. Nasdaq OMX Riga may require the issuer to enter into an arrangement with a market maker to support the liquidity of a given financial instrument.

12 Nasdaq Listing Rules, s 4.1.
13 Nasdaq Listing Rules, s 10.1.4.
14 Nasdaq Listing Rules, s 4.2.

Shares and equivalent transferable securities that ensure participation in a company's share capital are admitted to the Primary List if the following conditions are fulfilled:

- The issuer is carrying on business for at least three years and is engaged in its main business activity;
- The issuer's annual financial statement for the last year has been prepared in accordance with the international accounting standards (IAS);
- The expected market capitalization of the listed shares is at least €4 million;
- The issuer requests admitting all the shares of the respective share class to the primary list; and
- No later than on the day of commencing trading of the shares, a sufficient number of shares is held by the public.[15]

Quantitative and qualitative requirements for the admission of shares or equivalent securities to the Second List are set out in the Financial Instruments Market Law:

- The expected market capitalization for the listed shares is at least €1 million;
- The issuer's financial statements for the last three years are publicly available;
- The company requests admitting all the shares of the respective share class to the Second List; and
- No later than on the day of commencing trading of the shares, a sufficient number of shares is held by the public, this condition being fulfilled if at least 25 per cent of the shares the admission of which is sought on the stock exchange are held by the public or Nasdaq OMX Riga considers that there will be sufficient market liquidity for the respective shares.[16]

The issuer may apply for the inclusion of financial instruments in the Pre-List prior to listing on the Primary List or the Second List if the issuer cannot fully comply with the requirements for the admission to the Official List or the Second List. Nasdaq OMX Riga may transfer shares to another list if the issuer does not comply with the requirements of the respective list.

Financial instruments may be transferred to the Surveillance List with the purpose to alert the market on specific circumstances and measures associated with a given issuer. The Surveillance List is a part of the Official List, the Second List, and the Pre-List.

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15 If it is impossible to forecast marker capitalization, shares may be admitted to the Second List if the paid-up share capital and reserves (including profit and losses) in the last financial year were at least €1 million.

16 Financial Instruments Market Law, art 42.

Baltic Alternative Market First North. The First North Rules do not impose requirements regarding the minimum percentage of shares to be held by the public, minimum trading records before admission, minimum market capitalization, or other quantitative requirements for the admission of securities to trading.

The Financial Instruments Market Law adheres to the principle of mandatory prospectus disclosure, ie, it is unlawful to offer financial instruments to the public in Latvia or to request that they be admitted to trading on a regulated market operating in Latvia unless an approved prospectus has been made available to the public before the offer or request is made. Thus, all initial public offerings fall within the scope of a mandatory prospectus requirement, including those where the financial instruments are admitted to trading on the First North. However, mere admission of financial instruments on the First North is not an admission to trading on a regulated market and therefore will not trigger the prospectus requirement in the absence of a public offer.

A public offer designates communication (information) by any means on the offer terms and the offered transferable securities that enable the investor to make a decision on the acquisition or subscription of such securities. A public offer may be made only on receipt of the Financial and Capital Market Commission decision on permission to make a public offer.[17] This definition is broad enough not only to cover newly issued shares but also secondary offers by shareholders. A placing of transferable securities through an intermediary also would be covered,[18] but communications in relation to trading on certain markets or trading venues fall outside the definition.

There are certain exemptions from the mandatory prospectus requirement that mirror the provisions of the EU Prospectus Directive that apply by reference to the number of investors, capital being sought, sophistication of investors, or the minimum purchase price of securities. The Financial Instruments Market Law distinguishes two types of prospectuses:

- A prospectus for the initial public offering; and
- A prospectus for admission of financial instruments to a regulated market.

The prospectuses are equivalent in substance; therefore, an issuer who intends to offer securities for subscription via a regulated market, or intends to request admission of securities to trading on a regulated market immediately after the initial allotment, may prepare and submit to the Financial and Capital Market Commission a single prospectus. The format and content of the prospectus is set out in the EU Prospectus Directive Regulations.[19] An issuer seeking admission

17 Financial Instruments Market Law, art 1(39).

18 Financial Instruments Market Law, art 15(3).

19 Commission Delegated Regulation (EU) 486/2012 of 30 March 2012, amending Regulation (EC) 809/2004 as regards the format and the content of the prospectus, the base prospectus, the summary, and the final terms and as regards the disclosure requirements.

to trading on the First North (without public offer of securities) must produce only an admission document (description of the company), the prescribed contents of which are less onerous than the prospectus requirements.[20]

The Latvian regulatory framework for corporate governance comprises a number of sources, these being the Commercial Law, the Financial Instruments Market Law, the Nasdaq Listing Rules, and Nasdaq OMX Riga Corporate Governance Principles and Implementation Recommendations (the 'Corporate Governance Principles').[21] The laws and regulations establish basic standards of conduct and transparency, while the Corporate Governance Principles rely on self-regulation as a means of maintaining good corporate governance.

The Nasdaq Listing Rules rely on the 'comply or explain' approach. Under this approach, a listed company must report to its shareholders on how it has applied the Corporate Governance Principles and, where it has not applied them as envisaged, provide an explanation as to why it has not done so. Shareholders can then decide whether they are satisfied with the company's corporate governance practices.

The Corporate Governance Principles recognize that 'one size fits all' approach may not be suitable for all the companies and, when making decisions on governance practices, the management board can make judgments, taking into account the size and complexity of the company and the nature of the risks and challenges it faces.

The 'comply or explain' approach relies on shareholders and boards to scrutinize their companies. The legal framework seeks to ensure that shareholders have the necessary information to judge the governance practices of the company, and the rights necessary to hold the board to account if such practices are found wanting. In particular, the issuer included in the official list must file a report on the implementation of corporate governance principles to Nasdaq OMX Riga together with an audited financial statement.[22]

This requirement, however, does not apply to issuers of the securities admitted to trading on the First North. Shareholders can then discuss the position with the company and may take action to influence the board using their voting powers. In particular, under the Commercial Law the shareholders have a right to appoint and dismiss individual members of the supervisory board of a public company,[23] to call an extraordinary general meeting,[24] to request the necessary information from the management board[25] and to approve the remuneration of the members of the supervisory board and the internal auditor

20 First North Rules, s 6.
21 Nasdaq OMX Riga Corporate Governance Principles and Recommendations for Their Implementations, May 2010.
22 Nasdaq Listing Rules, s 15.14.
23 Commercial Law, art 268(1)(3).
24 Commercial Law, art 270(1).
25 Commercial Law, art 283.

and the principles and criteria for determining the remuneration of the members of the management board and supervisory board.[26] The Corporate Governance Principles contain principles which set out broad tenets of good corporate governance practice, and more specific provisions. The most important principles are summarized below.

The issuer should ensure the shareholder equality of the same class of shares (eg, right to information and dividends).[27] There should be a dialogue with shareholders based on the mutual understanding of objectives. The board should use the annual general meeting to communicate with investors and encourage their participation.

The management board and supervisory board should have appropriate skills, experience, independence, and knowledge enabling them to discharge their respective duties and responsibilities effectively.[28] It is recommended that at least half of the supervisory board should be made of independent directors.[29]

The board is responsible for maintaining sound risk management and internal control systems. The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles, and for maintaining an appropriate relationship with the company's auditor.

The issuer should establish the management and supervisory board remuneration policies that should set out criteria and types of remuneration payable to the board members (fixed and variable remuneration, share options, and other incentives). There should be a formal and transparent procedure for developing policy on executive remuneration.[30]

Registration of Public Offerings. The issuer is allowed to make a public offering or apply for the admission to a regulated market, as the case may be, only after the approval of the prospectus by the Financial and Capital Market Commission. The issuer should file an application to the Financial and Capital Market Commission together with two originals of the prospectus and a decision of the issuer's executive body regarding the issuing and public offering of the securities.

The Financial and Capital Market Commission decides on granting or refusing permission to make a public offer within 10 days from the date of receipt of the necessary documents.[31] The Financial and Capital Market Commission may refuse to issue a permit if the information in the documents does not comply with the statutory requirements, the issue does not comply with the

26 Commercial Law, arts 268(1)(9) and 268(1)(11).
27 Corporate Governance Principles, s 1.
28 Corporate Governance Principles, ss 4 and 7.
29 Corporate Governance Principles, s 7.6.
30 Corporate Governance Principles, s 14.
31 Financial Instruments Market Law, art 14(4).

laws, or the issue may prejudice the investors' interests.[32] The Financial and Capital Market Commission publishes the prospectus and its decision on its website and sends the prospectus to the European Securities and Markets Authority. The issuer is allowed to make a public offering within one month from the date of receipt of a positive Financial and Capital Market Commission decision.

Registration of Placements. According to the Financial Instruments Market Law, the mandatory prospectus disclosure requirement does not apply to the following types of offers:

- An offer of securities addressed solely to qualified investors;
- An offer of securities addressed to fewer than 150 natural or legal persons per member state, other than qualified investors;
- An offer of securities addressed to investors who acquire securities for a total consideration of at least €100,000 per investor, for each separate offer;
- An offer of securities whose denomination per unit amounts to at least €100,000; and
- An offer of securities with a total consideration of less than €100,000, which limit shall be calculated over a period of 12 months.[33]

These exceptions seek to facilitate non-retail offers, including initial public offerings to institutions' investors. The above exemptions may be of a particular relevance in case of international offerings where a large tranche of securities is offered to foreign institutional investors outside the territory of Latvia, while a smaller tranche is offered to retail investors in Latvia. The exemption, however, applies to public offers only. If the issuer requests admission of securities to trading on a regulated market, an admission prospectus is necessary unless other exemption applies.[34]

Furthermore, the mandatory prospectus requirement does not apply to offers of certain types of securities to the public and admission of such securities to trading, e.g., shares issued in substitution for shares of the same class already issued, securities offered in connection with a takeover by means of an exchange offer, shares offered, allotted, or to be allotted free of charge to existing shareholders, and dividends paid out in the form of shares of the same class as the shares in respect of which such dividends are paid, or securities offered, allotted or to be allotted, to existing or former directors or employees by their employer which has securities already admitted to trading on a regulated market.[35]

32 Financial Instruments Market Law, art 14(7).
33 Financial Instruments Market Law, art 16(2).
34 Financial Instruments Market Law, art 47.
35 Financial Instruments Market Law, arts 16(1) and 47.

Registration of Secondary Trade. The issuer may request admission of securities to the regulated market after initial subscription and allotment of securities. The issuer should file with Nasdaq OMX Riga an application for the admission of financial instruments to trading on a regulated market not later than three months from the date of registration of the prospectus with the Financial and Capital Market Commission.

The issuer registered in another EU member state may request admission of securities to trading on the regulated market only after the prospectus has been registered with the Financial and Capital Market Commission or the prospectus registered with the competent authority of the home state of the issuer has been passported to Latvia.

Periodic Disclosure

Periodic Financial Reporting

The Financial Instruments Market Law sets out requirements for publishing annual and interim financial reports that apply to issuers that have securities admitted to trading on a regulated market situated or operating within Latvia. A company registered in Latvia or in a foreign country whose transferable securities are admitted to the official list must prepare its annual financial statement according to IAS and International Financial Reporting Standards (IFRS), as endorsed by the European Commission,[36] and it must file it with the market organizer.

The annual financial report must include an audited financial statement, a management report, responsibility statements, and corporate governance report.[37] The annual financial report must be disclosed in full to the public together with an audit report. The management report must provide all the material information that enables investors to assess the trends in the company's business and profit or loss, all specific circumstances affecting business, and future prospects of the company in the relevant period.

A company whose shares are admitted to trading on a regulated market must submit to Nasdaq OMX Riga quarterly reports (three, six, nine, and 12-month) that have been prepared in accordance with the laws of the country of origin and the regulations of the market organizer.[38] Half-yearly and 12-month financial reports must include a condensed financial statement, an interim management report, and responsibility statement. The interim management report must provide an explanation of material events that have taken place in the relevant period, the main risks and uncertainties in the forthcoming six months of the fiscal year that could affect the financial position and performance of the issuer, and a fair review of the major related-party

36 Financial Instruments Market Law, art 56(3).
37 Financial Instruments Market Law, art 56(1).
38 Financial Instruments Market Law, art 57(3).

transactions.[39] Quarterly three-month and nine-month reports consist of a condensed financial statement and interim management report, if there are substantial changes in the information provided in the previous interim report.[40]

Companies whose securities are admitted to trading on the First North are subject to less onerous financial reporting requirements than those traded on a regulated market. The companies are allowed to prepare annual financial statement according to the standards of the issuer's registration country.[41] Furthermore, companies, instead of preparing quarterly financial statements, must prepare only half-yearly financial statements. The issuers admitted on the regulated market have to disclose all the mandatory information in Latvian and English,[42] whereas the issuers admitted to the alternative market may disclose the information only in Latvian.

Ad Hoc Disclosure of Information

An issuer whose financial instruments are admitted to trading on the regulated market must notify the market organizer of material events, ie, any events relating to the issuer that the issuer knows or ought to have known, and that are likely to influence the price of the issuer's financial instruments admitted to trading on the regulated market, or investors' decision to buy or sell financial instruments. The ad hoc disclosure requirements applicable to issuers admitted to First North are substantially similar to those of the regulated market.[43]

Material events include, among others, decisions of annual general meetings, preliminary financial results, dividend payments, changes in the company management, notification on financial developments, material agreements, court proceedings, mergers, acquisitions, reorganization, insolvency and similar proceedings, secondary listing, and changes in the shareholder structure.[44]

The issuer discloses the mandatory information via media and other information channels with a view to ensure, as far as possible, broad reach of the public and dissemination of information in the origin member state and other EU and European Economic Area (EEA) member states. Simultaneously, the issuer must post the information in the central storage system of regulated information,[45] ie, a publicly available web site devoted to publishing information on the issuers of securities.

39 Financial Instruments Market Law, art 57(4).
40 Financial Instruments Market Law, art 57(5).
41 First North Rules, s 22.1.1.
42 Nasdaq Listing Rules, ss 13.4.5–13.4.7.
43 First North Rules, ss 23 *et seq*.
44 Financial Instruments Market Law, art 59.
45 Financial Instruments Market Law, art 642(1); the Central Storage of Regulated Information in Latvia is available at https://csri.investinfo.lv/eng/.

Foreign Issuers

Domestic issuers and foreign issuers (ie, issuers with legal address in another country) are generally subject to the same set of the ongoing disclosure requirements. A foreign company whose transferable securities are admitted to trading on a regulated market in Latvia must prepare an annual report according to the IAS and IFRS and must file it to the market organizer in accordance with the procedure established thereby. In addition, quarterly and half-yearly reports must be submitted to the market organizer prepared in compliance with laws of the company's registration country.

Third-country issuers are exempt from Latvian law requirements regarding the preparation of annual reports and interim financial reports if the information provided, according to the law of the country, where the issuer's legal address is situated, is the same as prescribed by Latvian laws or the Financial and Capital Market Commission considers that such information is equivalent to Latvian law requirements. However, the information covered by the requirements of that third country must be filed and disclosed according to the same procedure as applicable to domestic issuers.[46] A foreign issuer also must disclose information that is disclosed in a third country which may be of importance to the public in Latvia, even if such information is not mandatory information, via mass media in Latvia and the Latvian central storage system of regulated information.[47]

Furthermore, Latvian law provides for a minimum set of equivalence criteria with respect to third-country management reports and financial reporting standards. If the issuer's legal address is in a third country and its management report has been prepared in accordance with the law of that country, it is considered to be equivalent to Latvian law requirements if it at least provides a clear overview of the issuer's business trends and financial results, as well as the main risks and uncertainties to which the issuer is exposed, information on any material events from the end of the previous fiscal year, and information on the expected development of the issuer.[48]

Latvian law extends the mandatory use of IFRS to third-country issuers in preparing consolidated financial statements. This approach is consistent with the endorsement of IFRS at the EU level,[49] and the EU attempts to facilitate convergence of international accounting standards at an international level on the basis of IFRS. Nevertheless, in certain cases, third-country issuers are allowed to use financial statements prepared otherwise than in accordance with IFRS provided that accounting standards, under which they have been drawn up, are recognized as equivalent by the European Commission. In particular, the

46 Financial Instruments Market Law, art 63(1).

47 Financial Instruments Market Law, art 63(2).

48 Financial Instruments Market Law, art 631(1).

49 Commission Regulation (EC) 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) 1606/2002 of the European Parliament and of the Council.

Financial Instruments Market Law recognizes the equivalence of the following accounting standards:

- IFRS provided that the notes to the audited financial statements that form part of the historical financial information contain an explicit and unreserved statement that these financial statements comply with IFRS in accordance with IAS 1 Presentation of Financial Statements; and
- GAAPS of the United States, Japan, China, Canada, South Korea, and India.[50]

If a third-county issuer does not use IFRS or equivalent international financial reporting standards, a consolidated annual report is considered to be equivalent to Latvian law requirements regarding consolidated annual reports in relation to securities admitted to trading on a regulated market, if it includes information on the calculation of dividends and ability to distribute dividends (share issues only) and liquidity and minimum capital requirements of the issuer, if such requirements are set out in the laws of the respective country.[51] Furthermore, under the Nasdaq Listing Rules, the issuers that are not registered (incorporated) in Latvia are allowed to disclose the information thereunder only in English.[52]

ADR Disclosure

Depository receipts can be admitted to an official list and to the Nasdaq OMX Riga regulated market,[53] in which case the continuing disclosure obligations will apply. Latvian law and Nasdaq Listing Rules do not differentiate between the ongoing obligations applicable to depository receipts and the securities represented by the depository receipts. In the case of depository receipts representing securities issued, the issuer is deemed to be the issuer of the securities represented by the depository receipts.[54]

Proxy Disclosure

Latvian commercial law provides for general rules on compensation disclosure, conflicts of interest and the shareholder right to request the necessary information from the management board. As noted above, under the Nasdaq Listing Rules, the issuer must file a report on the implementation of corporate governance principles to Nasdaq OMX Riga together with an audited financial statement and publish them on its web site.

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50 Commission Implementing Decision of 11 April 2012, amending Decision 2008/961/EC on the use by third countries' issuers of securities of certain third country's national accounting standards and International Financial Reporting Standards to prepare their consolidated financial statements; art 631(41) of the Financial Instruments Market Law does not yet list India among the countries with equivalent accounting standards.

51 Financial Instruments Market Law, art 631(43).

52 Nasdaq Listing Rules, s 13.4.8.

53 Nasdaq Listing Rules, s 2.1.3(4).

54 Financial Instruments Market Law, art 1(1)(12).

Compensation Disclosure

The issuer should publish on its web site a report on the remuneration policies of its management bodies that should at least provide information on the application of remuneration policies in the previous fiscal year with respect to the management board and supervisory board members, proportion of a fixed and variable remuneration for the respective category of management and other bonuses and incentives (if the information is commercially sensitive and can prejudice the interests of the issuer, the issuer may invoke a disclosure exemption).

Furthermore, the issuer must disclose information on the total compensation of the management board and supervisory board members (but not the remuneration of other key employees having significant impact on the company).[55] Unfortunately, the rules suffer from formalism since there is no express requirement to provide information on how the company's compensation practices could impact the incentives of the board members to take risks and how that would affect the company's risk profile.

Disclosure about Directors

The issuer should publish information on its web site relating to the qualifications of the management board and supervisory board members and directorships they have held in other companies during the past three years, ownership of the issuer's shares or shares in subsidiaries or parent companies of the issuer, and term of the supervisory board member.[56] This requirement, however, does not apply to other key employees.

Oversight of Risks

The management board should introduce adequate corporate and accountability structures and shall confirm in the annual financial statement that internal risk control procedures are efficient and that internal control was performed in accordance with the respective procedures.[57] However, there is no express duty to provide reasons for the chosen leadership structure and the role of the management bodies in the oversight of various risks.

The issuer must establish an internal audit committee in charge of overseeing preparation of financial statements and consolidated financial statement (if any), efficiency of internal risk management and control system.[58] The issuer should publish information on the results of the internal audit committee on its web site. Additional business conduct and disclosure requirements apply to licensed financial institutions.

55 Corporate Governance Principles, s 14.
56 Corporate Governance Principles, ss 7.1. and 10.5.9
57 Corporate Governance Principles, s 3.5.
58 Financial Instruments Market Law, s 541.

Trading Rules

Securities Offerings

Offer to Public

Financial instruments that are admitted to trading on a regulated market are offered to investors on the sixth day after a positive decision by Nasdaq OMX Riga. Nasdaq OMX Riga uses the INET Nordic trading platform for Nordic and Baltic equities trading. Trades on the regulated market may be effected as automatically matched trades or manual trades. Nasdaq OMX Riga accepts orders only from authorized brokers in the form specified in the resolution of the Nasdaq OMX Riga.

Orders participate in the opening call auction at the beginning of the trading hours; automatic matching in the trading system during the continuous trading and in the closing auction conducted after the trading hours as a result of automatically matched trades could be concluded.

Listed Securities

Trades concluded on the regulated market are settled by the Latvian Central Depository on net basis (delivery versus payment). Settlement day for trades that are concluded on the central and continuous market is T+3, but for block trades it may be from T+1.

On the settlement day the Latvian Central Depository checks whether all trade confirmations have been received from custodians and calculates net positions for securities and cash. If securities positions are sufficient for settlement, the Latvian Central Depository sends to Bank of Latvia an instruction to transfer cash on the settlement day.

If cash positions are sufficient for settlement, Bank of Latvia transfers cash and informs the Latvian Central Depository about cash settlement, consequently the Latvian Central Depository transfers securities. Finally, on the settlement day, the Bank of Latvia transfers cash and the Latvian Central Depository transfers securities.

Unlisted Securities

Over-the-counter trades with the financial instruments registered with the Latvian Central Depository, the Estonian Central Securities Depository, Lithuanian Central Securities Depository, and Clearstream Banking Luxembourg are settled on gross basis (delivery versus payment).

A Latvian Central Depository participant can settle the cash leg of its cross-border delivery versus payment over-the-counter transactions through an intermediary that is eligible for cash settlement at the Central Bank of Lithuania or Central Bank of Estonia. Latvian Central Depository participants can choose settlement day from T + 0 (real time basis) till T + 360.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties

Applicability of Latvian Law. The Latvian disclosure regime is concerned with control over or access to voting rights attached to issued shares, ie, it covers direct shareholdings, indirect interests (ie, access to voting rights) and certain financial instruments which give the holder an entitlement to acquire shares with voting rights attached. The substantial shareholder disclosure rules apply only to shareholdings in issuers that have their shares admitted to trading on a regulated market in Latvia.[59]

Thresholds. The thresholds for disclosure are when a person's holding of voting shares reaches, exceeds or falls below five per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 50 per cent, and 75 per cent of all the votes represented by the shares issued by the issuer.[60]

Additional thresholds of 90 per cent and 95 per cent of all the votes represented are applied to the holdings in issuers who have Latvia as their member state of origin,[61] ie, where the issuer is incorporated in the EU/EEA and has its registered office in Latvia, or where the issuer is incorporated outside the EEA and Latvia was the first member state in which its shares were publicly offered (after 31 December 2003) or an admission for trading in a regulated market was made. Shareholders of securities of unlisted issuers, or issuers who are listed only on a non-regulated market (First North), are not caught by the Latvian substantial shareholder disclosure regime.

Further shareholding disclosures apply to all companies registered in Latvia, whether listed on a regulated market in Latvia or not. The Groups of Companies Law requires disclosure (to the issuer) of acquisition of a shareholding, in a company registered in Latvia, in total also exceeding or falling below (but not reaching) 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 35 per cent, 40 per cent, 45 per cent, 50 per cent, 55 per cent, 60 per cent, 65 per cent, 70 per cent, 75 per cent, 80 per cent, 85 per cent, 90 per cent, and 95 per cent.

However, this obligation in practice is not widely applied and is rarely enforced. The disclosure obligation under the Groups of Companies Law requires disclosure by a shareholder to the issuer in case of exceeding applicable thresholds upwards or downwards. In practice, this disclosure obligation is relevant only if a shareholder is a nominee, or if the shares are bearer shares of a joint-stock company. The disclosure regime contains three main components:

- Disclosure of acquisitions or disposals of voting rights;
- Disclosure of indirect holdings of voting rights; and

59 Financial Instruments Market Law, art 60(1).
60 Financial Instruments Market Law, art 61(1).
61 Financial Instruments Market Law, art 61(2).

- Disclosure of entitlements to acquire voting rights under financial instruments.[62]

The following full or partial exemptions apply:

- Shares acquired for clearing and settlement purposes;
- Shares held by custodians or nominees;
- A collateral taker;
- Shares held by a market maker acting in that capacity, provided the holdings are below 10 per cent and subject to the market maker satisfying various criteria and complying with various additional requirements;
- A credit institution or investment brokerage company in their trading book where the voting rights do not exceed five per cent of all voting rights represented by shares issued by the issuer;
- Members of the European System of Central Banks; and
- A subsidiary is not required to make a disclosure because its parent (or the other company controlling the parent) has made the disclosure instead.

Notification must be made to the issuer and the Financial and Capital Market Commission as soon as possible, but in any event within four trading days. The notification is filed electronically using the electronic information system supported by the Financial and Capital Market Commission (the Central Storage of Regulated Information), and through this system the information is provided to the regulated market.[63]

Company Duties

A joint-stock company whose shares are admitted to trading on the regulated market must promptly make the share acquisition notification, received from a person who has acquired, directly or indirectly, a qualifying holding of shares with voting rights, publicly available in Latvia and each EU member state on whose regulated markets the shares of the joint-stock company are admitted to trading, but not later than within four business days of its receipt, in a manner that allows all shareholders to access the information.

In certain cases, the Financial and Capital Market Commission is entitled to exempt a joint-stock company from the obligation to publish information on shareholders who, directly or indirectly, acquired voting rights attached to the shareholding thresholds referred to in the Financial Instruments Market Law.

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62 Where a person has holdings of voting rights in more than one of the above three categories, he will need to aggregate these holdings for the purposes of calculating whether a disclosure is required.

63 Financial Instruments Market Law, art 642(2).

Insider Trading and Fraud

Basis of Territorial Link

The Financial Instruments Market Law provisions on prohibition of market abuse closely follow the EU Market Abuse Directive. In particular, the Financial and Capital Market Commission must ensure that prohibition of insider dealing and market manipulation applies to:

- Actions carried out in the territory of Latvia or abroad concerning financial instruments that are admitted to trading on a regulated market in Latvia regardless of whether the transaction takes place on or outside a regulated market or for which the issuer has adopted a request to commence trading on a regulated market in Latvia; or
- Actions carried out in the territory of Latvia concerning financial instruments admitted to trading on a regulated market in another EU/EEA member state or for which the issuer has adopted a request to commence trading on a regulated market in another EU/EEA member state.[64]

The Financial Instruments Market Law provisions on the prohibition to use inside information apply also to financial instruments that have not been admitted to a regulated market in Latvia or another EU/EEA member state, but whose price depends on the financial instruments traded on a regulated market in Latvia or another EU/EEA member state.[65]

The inside information is defined along the lines of the Market Abuse Directive.[66] Persons who know or ought to have known that the information is inside information are liable for disclosing such information.

As concerns the prohibition of market manipulation, Latvian law goes beyond the Market Abuse Directive since the law prohibits not only market manipulation, but also unfair transactions, ie, transactions which do not comply with the general provisions of the Civil Law and that infringe the rights and legitimate interests of the counterparty and other parties.[67] The Financial and Capital Market Commission enjoys extensive powers to counter market abuse, including the right to:

- Request that any person provides information on his activities in the financial and capital markets;
- Request that participants of the financial instruments market cease any action that are contrary to the provisions of the Financial Instruments Market Law;
- Suspend trading in financial instruments; and

64 Financial Instruments Market Law, art 84(1)–(3).
65 Financial Instruments Market Law, art 84(4).
66 Financial Instruments Market Law, art 85(1) and (2).
67 Financial Instruments Market Law, art 88(2).

- Restrict the activities of a participant of the financial instruments market for up to six months.[68]

Under the Criminal Law, insider dealing and market manipulation that has resulted in material harm (the infringement has resulted in damages of five minimum wages and endangerment of other legally protected interests) may be sanctioned with a deprivation of liberty for up to three years. Qualified insider dealing and market manipulation (committed by an organized group or resulting in damages of 50 minimum wages) are sanctioned with the deprivation of liberty from two to 10 years.[69]

Extraterritorial Application

Latvian laws have extraterritorial effect where a party is engaging in market abuse outside the territory of Latvia with respect to financial instruments that are admitted to trading on a regulated market in Latvia regardless of whether the transaction takes place on or outside a regulated market or for which the issuer has adopted a request to commence trading on a regulated market in Latvia.

The enforcement of these Latvian anti-abuse laws, however, depends on the efficiency of cooperation between the Financial and Capital Market Commission and competent authorities of countries where the infringement has been committed. There are no publicly available records of cases when the Financial and Capital Market Commission or other investigative authorities had sought to enforce the Latvian anti-abuse laws outside the territory of Latvia.

Public Takeover Bids

Territorial Application (Foreign Bidder-Domestic Target)

Latvian law on takeovers closely follows the EU Takeover Directive[70] that establishes takeover mechanisms and safeguards the shareholders' rights. The Financial Instruments Market Law provisions on takeovers apply only to companies with shares admitted to trading on a regulated market in Latvia. There are no specific provisions relating to takeovers of companies the shares of which are held by the public, but are not admitted to trading on a regulated market.

Making of a takeover bid is supervised by the Financial and Capital Market Commission if the shares of the target company are admitted to trading on a regulated market in Latvia regardless of whether the target company has a registered office in Latvia or abroad.

68 Financial Instruments Market Law, art 90.
69 Criminal Law, art 193.
70 Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (the 'Takeover Directive').

Where the shares of the target company are admitted to trading on regulated markets in Latvia and in one or several other EU/EEA member states, the making of a takeover bid is supervised by the Financial and Capital Market Commission if the shares were first admitted to trading on the regulated market in Latvia. Where the shares of the target company are simultaneously admitted to trading on a regulated market in Latvia and in one or several other EU/EEA member states, the target company may determine which of the supervisory authorities of the relevant member states will supervise the bid.[71] A mandatory takeover bid must be made by any person or persons acting in concert that:

- Have acquired, directly or indirectly, shares of the target company representing at least 50 per cent of the voting power in the company; and
- Have voted at the shareholders meeting of the target company in favor of excluding the company from a regulated market.[72]

A person has a right to make a voluntary takeover bid if, as a result of acquisition of the shares for which the bid is made, the person would have acquired at least 10 per cent of the voting power in the target company. As opposed to the mandatory takeover bid where the offeror is required to make the bid in respect of all of the shares of the remaining shareholders, a person making a voluntary takeover bid may fix the minimum or maximum number of shares that he is willing to purchase.[73]

Connecting Factors in International Private Law Aspects

Matters relating to the consideration for the bid and matters relating to the takeover procedure, in particular the information on the offeror's decision to make a bid, the contents of the offer document, and the disclosure of the bid, are governed by the law of the EU member state of the competent authority. Accordingly, the Financial Instruments Market Law will apply to such matters where the Financial and Capital Market Commission is the competent authority.

Matters relating to the information to be provided to the employees of the target company and matters relating to company law, in particular the percentage of voting rights which confers control and any derogation from the obligation to launch a bid, as well as the conditions under which the board of the target company may undertake any action which might result in the frustration of the bid, are governed by the law of the EU member state in which the target company has its registered office.[74]

Thus, these matters will be governed by Latvian law if the company's registered office is in Latvia. If, however, the company's registered address is in another

71 Financial Instruments Market Law, art 691.
72 Financial Instruments Market Law, art 66(1).
73 Financial Instruments Market Law, art 67(1) and (2).
74 Takeover Directive, art 4(2)(e).

country and the company's shares are admitted to the regulated market, these matters will be governed by the law of the country where the company has its registered address.

Procedural Requirements

The offeror must file with the Financial and Capital Market Commission a takeover prospectus within 10 business days from the occurrence of the circumstances triggering the obligation to make a mandatory takeover bid or the offeror's decision to make a voluntary takeover bid. The prospectus must be accompanied by an assessment of the offer price, the offeror's registration or identification document, and documents evidencing availability of funds in order to meet liabilities under the bid within the prescribed time period. Additional requirements apply if the takeover bid is made by persons who have voted in favor of the exclusion of the shares from the regulated market.

A takeover prospectus should provide a target company's details, detailed information on the offeror, the type of bid (mandatory or voluntary), price per share and methods for determination thereof, procedures and time periods for the payment and exchange of shares, validity of the offer, procedure whereby the shareholders of the target company are entitled to accept the offer, and any other relevant information directly applicable to the bid or to the offeror and considered necessary by the offeror or the Financial and Capital Market Commission.[75]

Upon receipt of the takeover prospectus, the Financial and Capital Market Commission must publish information on the offeror, price per share, and the validity of the offer in the official storage system and notify this information to Nasdaq OMX Riga, which must post such information on the website. The Financial and Capital Market Commission takes a decision on the permission to make the offer within 10 business days from the date of receipt of all the necessary documents.[76] The time allowed for acceptance of the offer may not be less than 30 days and more than 70 days from the date of making the bid.[77]

Exemptions

The mandatory takeover bid requirement does not apply to a person or persons acting in concert who has or have acquired shares in the target company reaching or exceeding the 50 per cent threshold if the acquisition is a result of a voluntary takeover bid that was made to acquire shares of the target company representing at least 50 per cent of the voting power in the company and was made to all shareholders of the target company in respect of all shares of the target company.

75 Financial Instruments Market Law, art 71.
76 Financial Instruments Market Law, art 72.
77 Financial Instruments Market Law, art 69(3).

In such case, the offer price should be determined as in the case of a mandatory takeover bid. Furthermore, exemption applies where a person or persons acting in concert, when making the mandatory takeover bid as a result of voting for the exclusion of the target company from the regulated market, acquired shares of the target company representing at least 50 per cent of the voting power in the company during or as a result of such mandatory takeover bid.

Recognition of Foreign Take-Over Regulation

The offeror is allowed to make a takeover offer for shares in a company that are admitted to trading on the regulated market by filing a takeover prospectus approved by the competent authority of the member state where the company is registered (together with a notarized Latvian translation) without it being necessary to obtain approval of the Financial and Capital Market Commission. The prospectus, however, should be supplemented with information on the formalities for accepting of the offer and paying consideration to the target company's shareholders in Latvia.[78]

Jurisdiction Conflicts

Genuine and False Conflicts

Latvian securities laws are territorial in nature and they are applicable only where a nexus exists with Latvia. Under the Financial Instruments Market Law, such nexus is defined by a variety of criteria, such as registration of the securities with the Latvian Central Depository, admission of the securities to trading on a regulated market operating in Latvia, or trading on a market operating in Latvia.

Exterritorial effect of Latvian anti-abuse laws, which are applicable also to activities outside the territory of Latvia concerning financial instruments admitted to trading in the regulated market, is a notable exception from the general principle. This exception underlines the importance Latvian law attaches to safeguarding the integrity of the regulated market in Latvia and protecting the investor interests.

Multilateral Approaches

Substantive Law Solutions

Latvia is actively engaged in EU harmonization efforts of securities regulations to remove obstacles for international offerings of securities and cross listings. However, EU-wide harmonization has been achieved only with respect of mandatory prospectus disclosure requirements and financial reporting standards of consolidated financial accounts of some segments (see text, above).

78 Financial Instruments Market Law, art 72[1].

Given limited success achieved thus far at a global level in harmonizing securities laws, Latvia has followed the European approach by adopting the concept of equivalence of third-party standards in some fields to remove obstacles to international public offerings. In particular, the Financial and Capital Market Commission may register a prospectus that is prepared according to the laws of a third country if the prospectus is prepared in accordance with international standards (including IOSCO international disclosure standards) and the information (including financial information) disclosure requirements are equivalent to those set forth in the Financial Instruments Market Law.

In the field of financial reporting, Latvia is engaged in the European efforts in promoting convergence of international accounting standards at a global level, but in the meantime recognizes the limited equivalence of foreign accounting standards. In particular, if a third-country issuer does not use IFRS or equivalent international financial reporting standards, the issuer's consolidated annual report is deemed to be equivalent to Latvian law requirements regarding consolidated annual reports in relation to securities admitted to trading in a regulated market if it includes prescribed information that enables the investors to make similar assessment of the financial position of the issuer as under the reports drawn up in accordance with IFRS.

Recognition

Under Latvian law, mutual recognition of foreign standards is limited to areas where maximum harmonization has been achieved at the EU level (eg, mandatory prospectus disclosure requirements). In particular, under the EU 'single passporting' regime, Latvian companies may passport the prospectus approved by the Financial and Capital Market Commission to another EU/EEA member state in order to access foreign capital markets.

In addition, translation burdens have been significantly lightened. If an issuer registered in another EU member state intends to make a public offer in Latvia, only the summary prospectus needs to be in Latvian. If, however, the issuer makes a public offer in more than one member state, including Latvia, the prospectus needs to be prepared in a language that has been recognized by the respective competent authorities of the member states and the Financial and Capital Market Commission or a language that is used in international finance (eg, English). Only a summary prospectus needs to be prepared in Latvian.[79]

As regards non-EU issuers, the Financial and Capital Market Commission may register a prospectus that is prepared according to the laws of a third country if the prospectus is prepared in accordance with international standards (including IOSCO international disclosure standards) and the information (including financial information) disclosure requirements are equivalent to those set forth in the Financial Instruments Market Law.[80] Latvian law does not provide for

79 Financial Instruments Market Law, arts 22^1 and 49^1.
80 Financial Instruments Market Law, art 23.

mutual recognition of listing decisions on a regulated market. Admission to the official list of a stock exchange operating in another EU/EEA member state does not bring with it the right to list automatically on Nasdaq OMX Riga stock exchange.

Procedural Solutions

Determination of court jurisdiction and recognition and enforcement of judgments of foreign court decisions is subject to generally applicable provisions on international civil procedure. The Brussels I Regulation,[81] as applicable within the EU, generally allocates jurisdiction on the basis of the defendant's domicile,[82] but in tort claims provides also for jurisdiction in the courts of the location of the harmful event.[83] The judgments delivered by the courts of other EU member states obtained in accordance with the Brussels I Regulation are recognized and enforceable in Latvia.

The enforcement of a judgment of a third-country court is possible only in accordance with the Civil Procedure Law. According to the Civil Procedure Law, a judgment (a court judgment that resolves the dispute on the merits or a court-approved settlement) of a foreign court will not be recognized if only one of the following bases for non-recognition exists:

- The foreign court that issued the judgment was not competent in accordance with Latvian law to adjudicate the dispute or such dispute is an exclusive jurisdiction of the Latvian courts;
- The judgment of the foreign court has not come into legal effect;
- The defendant was denied a possibility of defending his rights, especially if the defendant who has not participated in the adjudication of the matter was not in a timely and proper manner notified regarding the hearing, except if the defendant has not appealed such decision even though he had the possibility to do so;
- The judgment of the foreign court is not compatible with a court judgment already made earlier and effective in Latvia in the same dispute between the same parties or with already earlier commenced court proceedings in such dispute in a Latvian court;
- The judgment of the foreign court is not compatible with such already earlier made and effective decision of another foreign court in the same dispute between the same parties, which may be recognized or is already recognized in Latvia;
- The recognition of the judgment of the foreign court is in conflict with the public order of Latvia; or

81 Council Regulation 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the 'Brussels I Regulation').
82 Brussels I Regulation, art 2.
83 Brussels I Regulation, art 5(3).

- In the making of the judgment of the foreign court, the law of such state was not applied as should have been applied according to Latvian private international conflict of law norms.[84]

The Latvian Civil Procedure Law does not provide the possibility of reopening a case and enforcing a foreign judgment after re-trial on the merits.

Unilateral Approaches

Latvian law does not recognize the doctrines of comity of self-restraint. In the absence of an international agreement between the countries or directly applicable EU regulations, decisions of foreign courts and authorities are recognized and enforced in Latvia in accordance with the Civil Procedure Law.

84 Civil Procedural Law, art 637.

Lebanon

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Lebanon

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Introduction

In General

The Beirut Stock Exchange was established in 1920 immediately after World War I. The Beirut Stock Exchange was the first in the Middle East and, thus, it attracted investments from the entire region as well as from European countries, mainly France, of which Lebanon was a protectorate until 1946.

Trading on the Beirut Stock Exchange prospered in the 1950s and 1960s. However, it slowed with the beginning of the war in 1975. In 1983, the Stock Exchange Commission suspended its activities, as the whole economic activity in Lebanon was seriously disrupted. In September 1995, the Beirut Stock Exchange was officially reopened, and it began trading in January 1996.

Regulatory System

In General

Lebanon offers the most liberal investment climate in the Middle East, with no significant restrictions on investment, liberal trade, clear foreign investment policies, local investment guarantee coverage, bank secrecy and a free currency exchange regime with no control on capital flows, low taxes with a flat 15 per cent corporate tax, 10 per cent tax on dividends, and 7.5 per cent withholding tax, well-defined legal rights for property, business legal frameworks with different types of companies and legal structures, and a generally efficient and reliable judicial system operating on a clear set of rules pertaining to integrity and impartiality.

Foreign investors can virtually invest in any sector, except for certain areas related to national security. There are also certain restrictions on real estate ownership by non-Lebanese as well as on the ownership and management of public utilities.

In an effort to attract foreign direct investment, the government is currently considering privatising some of the public services and has resorted in many cases to BOT-type contracts. The government is also issuing dollar-denominated Euro bonds and, recently, for the first time, issued German mark-denominated Euro bonds to finance major projects.

In 2004, Lebanese Government Eurobonds were introduced on the stock exchange.

Stock Exchange Market

The Lebanese regulatory system aims at ensuring that companies have access to capital while preserving investors' confidence in the market. This has been achieved thus far by confining the performance of brokerage activities solely to duly licensed institutions. This will ensure that only qualified and financially sound institutions are involved in the trading of securities.

Furthermore, the requirement of a periodic disclosure of financial and administrative reports intends to enable investors to make decisions on an informed basis. It is important to note that the Lebanese 2000 Budget Law of 14 February 2000, in an effort to encourage companies to list their securities, has reduced the tax on dividends from 10 per cent to five per cent for companies listed on the Beirut Stock Exchange.

Legal Sources

Lebanon has a Civil Law legal system, similar to the French system, with minor differences. Prior to 1963, the banking and financial instruments sector was governed by very broad terms in the Code of Commerce.

The main legal text organising the above-mentioned activities is the Code of Money and Credit (1963), which organised banking and financial services. The Beirut Stock Exchange was organised by Decree-Law Number 120 (1983) and dealt with regulations pertinent to the dealings within the Beirut Stock Exchange.

Law Number 520 (1996) regulated for the first time the development of financial markets and fiduciary contracts. In an attempt to complete the legal framework of financial instruments and brokerage activities, Law Number 234 (Organisation of Brokerage Activities) was promulgated on 10 June 2000.

In addition to these regulations, there are a number of internal rules issued by the self-regulatory bodies that supervise the functioning of the Lebanese stock market. For instance, the Stock Exchange Committee has been empowered to issue Circulars serving practical ends as well as to prepare all Bills designed to amend the existing legislation relating, whether directly or indirectly, to the Stock Exchange. Furthermore, the Stock Exchange Committee is in charge of drafting and amending the By-Laws of the Beirut Stock Exchange as necessary, knowing that such By-Laws and related amendments will be ultimately promulgated by Government Decrees.

Additionally, a new capital markets draft law is being prepared, inspired by the IOSCO 2003 principles. The implementation of the reform will attract foreign institutional investors whose presence is necessary for development and to allow the Beirut Stock Exchange to have its place among emerging capital markets.

Authorities

The Beirut Stock Exchange functions according to the provisions of the Law under the supervision of the Central Board of the Central Bank of Lebanon, the Stock Exchange Committee, and the Ministry of Finance.

The Central Board of the Central Bank of Lebanon is the main authority regulating and controlling the functioning of banks, financial institutions, and brokerage firms operating on the Lebanese market. This is achieved mainly by requesting a licence before engaging in any operation.

Once a licence is granted, the control is exercised by imposing on these institutions an obligation of disclosure relating to financial and administrative information.

The Stock Exchange Committee is responsible for managing the affairs of the Beirut Stock Exchange and provides for the proper functioning of its activities. One of the major roles performed by this committee is to take decisions with regard to the listing of any security on the Beirut Stock Exchange as well as admitting brokerage firms. It also will issue Circulars serving practical ends that may be deemed necessary.

The Ministry of Finance exercises supervision over the management of the Stock Exchange Committee. The Government Commissioner is appointed by the government as a representative and member of the Stock Exchange Committee. He is responsible for attending to the enforcement of, and the compliance with, laws and regulations relevant to the Beirut Stock Exchange. He may object to all resolutions of the Stock Exchange Committee that he may deem in breach of the laws and regulations provided that he is able to justify such objections.

Procedures

The procedure for listing securities and periodic disclosure aims at ensuring protection for investors by providing accurate and clear information about the financial and administrative status of issuers. Such transparency is necessary for assessing the risks of their investment.

There are two major markets for securities within the Beirut Stock Exchange, with no real differences beside capital requirements. Indeed, the Official Market is only accessible by companies with a substantial capital (equivalent to approximately US $3 million), whereas the over-the-counter market is accessible to companies with moderate capital and/or which are planning to join the Official Market after a certain 'training' period.

Legal Order and Regulatory Interests

Admission

Market Participants

In General. The right to negotiate securities listed on the Beirut Stock Exchange, whether in the Official Market or in the 'over-the-counter market', is limited to banks and financial institutions listed with the Central Bank of Lebanon[1] and licensed brokerage

1 The licence already granted by the Central Bank of Lebanon to banks and financial institutions allows them to perform brokerage activities.

firms. Therefore, only registered entities are entitled to perform as middlemen in the operations of purchases and sales on the Beirut Stock Exchange.

Prior to engaging in any brokerage activity, banks and financial institutions are required to obtain a decision of acceptance by the Stock Exchange Committee, whereas brokerage firms must follow a two-phase procedure. The first phase ends with the delivery of a licence by the Central Board of the Central Bank, which will allow the applying entity to be established as a brokerage firm. Once licensed, the brokerage firm, to be able to perform its activities, must apply for acceptance by the Stock Exchange Committee.

A brokerage firm must obtain a prior licence from the Central Board of the Central Bank of Lebanon before initiating its activities. Granting of such licence is subject to certain requirements, mainly:

- The applying entity must be a joint-stock company with a minimum capital to be determined by decision of the Central Board of the Central Bank;[2] and
- All shares of the brokerage firm must be nominative shares, at least one-third of which are owned by Lebanese nationals.

Any foreign company wishing to engage in brokerage activities shall establish a local branch according to the conditions set above.[3]

At the end of this procedure, the Central Board of the Central Bank will decide to grant or to refuse the licence on its own discretion. This decision cannot be subject to appeal.

Once licensed, any bank, financial institution, or brokerage firm must, to perform its activities on the Beirut Stock Exchange, obtain an acceptance in this respect by the Stock Exchange Committee. Such decision is subject to certain requirements, mainly:

- The applying entity must be a joint-stock company with a minimum capital of LBP 1 billion;[4]
- A proper bank guarantee must be issued exclusively in favour of the Beirut Stock Exchange by a bank operating in Lebanon, the value of which is set at LBP 200 million;[5] and
- The applying entity must submit to the Stock Exchange Committee an application for acceptance, which includes, mainly, a copy of the articles of incorporation of the company, financial reports and accounts for the last three years,[6] and a copy of all minutes of the company for the last three years.

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2 In practice, the minimum has been set at LBP 1 billion.
3 Registration of Lebanese branches of foreign companies takes place at the Ministry of Economy and Trade without any prior examination.
4 This condition is automatically fulfilled by obtaining the Central Bank's licence.
5 This guarantee will serve as collateral for any liability incurred by the agent, noting, however, that this responsibility may extend to further amounts. This means that the value of this guarantee may not constitute any limitation as to the agent's liability.
6 This requirement applies only to banks and financial institutions, since brokerage firms could not have established any activity before their acceptance by the Stock Exchange Committee.

By the end of this procedure, the Stock Exchange Committee will decide, on its own discretion, either to grant or to refuse the membership application. The resolution of the Stock Exchange Committee can, however, be appealed before the Civil Chamber of the Court of Appeal of Beirut within a delay of 15 days as per the date of notification of the decision to the concerned party.

MIDCLEAR. To ensure the efficiency and effectiveness of operations in the capital market and to provide safeguards for members, traders, and investors, the Central Bank of Lebanon established MIDCLEAR SAL in June 1994 in Beirut, as the custodian and clearing center for financial instruments for Lebanon and the Middle East.

MIDCLEAR's members are the Central Bank of Lebanon, local and foreign banks, local and foreign financial institutions, the foreign central securities depository, clearing houses, and issuers.

MIDCLEAR was appointed Central Depository for Lebanon and Central Registrar for all Lebanese bank shares.[7]

MIDCLEAR performs clearing and settlement services for local and internationally traded securities. Whatever the market, trades between MIDCLEAR members are settled on a 'delivery versus payment', in keeping with international procedures.

All orders transmitted to MIDCLEAR for clearing and settlement are considered irrevocable. MIDCLEAR will not partially settle trades. Settlement takes place on the trade date, plus three days. Thus, stock journal entries for deposit, withdrawal, and transfer are done with a same-day value, and trades executed on the exchange are recorded three working days after the trade date.

MIDCLEAR was appointed by the Central Bank of Lebanon on 2 July 2003 as the sole National Numbering Agency for securities issued in Lebanon. MIDCLEAR is the sole organisation entitled to allocate international security (ISIN) codes for all Lebanese securities issued in Lebanon. On 14 November 2003, MIDCLEAR became a full member of the Association of National Numbering Agencies (ANNA).

Electronic Trading System. There are no specific regulations concerning transborder electronic trading systems in Lebanon. The Central Bank, in an effort to modernise the stock exchange, enacted Circular Number 1810 in 2000, relating to electronic financial and banking transactions. The Circular governs activities that are concluded, carried out, or promoted through electronic means by banks, financial institutions, and financial intermediaries.

Every financial institution must inform the Central Bank in advance of its intention to carry out, partly or entirely, activities through electronic means. As regards transfers in Lebanon, a financial institution must:

- Have a capital of LBP 2 billion or, in the case of a foreign institution, allocate a similar amount to the operations of its branch in Lebanon;

7 Law Number 139 of October 1999; Law Number 308 of April 2001.

- Inform the Central Bank about the number and addresses of branches opened in Lebanon and the transfer equipment in use in each location and comply with the content of any objection by the Central Bank concerning these branches, at the risk of losing its license to operate in Lebanon;
- Comply with professional confidentiality;
- Buy insurance on its operations; and
- Provide evidence as to the effectiveness of its electronic protection system.

As regards transfers abroad, a financial institution must be connected to an international transfer network and comply with the requirements indicated above.

Off-Market Transactions. The by-laws provide that brokers admitted to the Beirut Stock Exchange may conclude among them 'direct transactions' outside the Stock Exchange according to the following rules:

- The Stock Exchange Committee must set a specific value for each security without which no 'direct transactions' may be concluded outside the Stock Exchange, and it must set the cost variance for each security; and
- The direct transactions concluded outside the Stock Exchange must be declared, by each party, according to the date set by the Stock Exchange Committee and in any case before the next session.

In addition, the Stock Exchange Committee may authorise, at any time, the conclusion of direct transactions inside the Stock Exchange, if the value of the operation does not exceed the amount indicated by the Stock Exchange Committee. The Stock Exchange Committee will specify the practical details for the conclusion of such transactions.

Securities

National Treatment and Reciprocity. Generally, Lebanese law makes no discriminatory or excessively onerous requirements inhibiting foreigners trading in securities. However, some restrictions exist on foreigners willing to acquire nominative equity shares related to companies owning real estate (ie, nominative shares representing property in real estate in Lebanon) and corporations involved in the management and running of public utility projects, where foreigners will be allowed to own a maximum of 66 per cent of such company's shares.

In addition, foreign investors are required to be cautious while investing in Lebanese companies holding exclusive representations and agencies for foreign trade marks or franchises.

It should be noted that Lebanese law is very protective[8] of such companies, provided that shareholders detaining at least 51 per cent of the total shares are Lebanese (obviously, those shares will be nominative). Therefore, it will be in the best interest of foreign

8 Local commercial agents and distributors enjoy a wide protection (eg, right to claim indemnity and right of renewal) under the provisions of Decree-Law Number 34/67 of 5 August 1967.

investors to avoid the acquisition of more than 49 per cent of the total shares, even if exceeding this barrier is not sanctioned by the annulment of the transaction.

Reciprocity is not required as a condition to allow foreigners the ownership and trading of securities in Lebanon. However, bilateral treaties have been conducted between Lebanon and other countries to facilitate the exchange and trading of securities (ie, Kuwait, Jordan, and Egypt).

Issuer Requirements. Some common conditions must be satisfied for the issue in both the Official Market and the over-the-counter market. Required documents are:

- A certified copy of the articles of incorporation and all their amendments, which should include an explicit text providing for the pricing of the issuer's securities in the Stock Exchange;
- All copies of the minutes of the general meetings and the board of directors registered in the Register of Commerce for the last three years or for the period between the date of incorporation and the date of submitting of the application;
- A detailed statement describing the nature, kind, and value of the securities meant to be listed;
- All of the balance sheets, profit-and-loss accounts, inventories, and consolidated annual accounts in the event the issuer has subsidiary companies;[9] and
- A general descriptive statement of the issuer's activity and markets.

Engagements

On filing the application for admission, the issuer must sign an engagement in the due form indicated by the Stock Exchange Committee, including mainly the obligation for him to provide periodically the Stock Exchange Committee and the public with financial statements and reports of various kinds and generally disclose any information that would have an impact on the financial or administrative state of the issuer.

The same conditions and commitments applying to the Lebanese issuer and stipulated in the by-laws apply similarly in their form and content to a foreign issuer wishing to apply for listing. The foreign issuer should present all of the documents required for Lebanese issuers, or their equivalent in the country of registration. The financial documents presented should necessarily conform to Lebanese or International Accounting Standards. The Stock Exchange Committee may request official Lebanese or foreign authentication of the documents constituting the file represented by the foreign issuer. This authentication should demonstrate the conformity of the documents presented to the laws and regulations in force in the country of registration.

9 This requirement is in addition to the reports of the board of directors and the auditors for the last three years or the period between the date of incorporation and the date of submitting the application.

For the Official Market, the capital of the issuer must be equivalent in Lebanese pounds to US $3 million. In the over-the-counter market, the capital of the issuer must be equivalent in Lebanese pounds to US $1 million.

Securities Requirements. The issuer's application for admission may cover:

- All categories of shares and all rights authorising their purchase, subscription, or allocation of rights;
- Bonds, including convertible bonds, provided the securities resulting from this conversion are traded on the Beirut Stock Exchange; and
- Bonds issued by public institutions or Lebanese joint-stock companies where the state is a shareholder.

The success of a security within the Stock Exchange's markets will depend essentially on the volume of transactions relating to it. Therefore, the by-laws have set a minimum diffusion threshold of 25 per cent. Consequently, any issuer who wishes to join either the Official Market or the over-the-counter market must have distributed, on the first date of the pricing at the maximum, at least 25 per cent of the shares of its capital among the public. Although the term 'public' has not been defined, one may imply that securities detained by members of the board of directors will not be considered as publicly held, whereas securities owned by the issuer's employees would be considered as such.

It is important to note that the by-laws provide that the number of shareholders owning the above-mentioned 25 per cent of the company's capital must be at least 50. If the Stock Exchange Committee has listed an issuer of bonds in the Official Market, the value of the issue must be the equivalent in Lebanese pounds of at least US $2 million. In case the listing took place in the over-the-counter market, the value of the issue must be the equivalent in Lebanese pounds of at least US $1 million.

Prospectus Requirements. In a clear distinction from most regulations, Lebanese laws do not give much emphasis to the prospectus issue.

Nevertheless, the Beirut Stock Exchange By-Laws provide that the issuer must publish a briefing of his admission file (Briefing Memorandum) immediately on the publication of the Stock Exchange Committee's decision in the Beirut Stock Exchange *Official Bulletin.* The intent of the Briefing Memorandum is to keep the public informed as to the issuer's financial and administrative status.

The Central Bank enacted in 1999 Basic Circular Number 7493, relating to 'trading in derivatives and other financial products and instruments'. The Basic Circular states that any bank or financial institution wishing to sell to the public any financial products or instruments in Lebanon must apply for the Central Bank approval.

Financial institutions should adopt transparency while dealing with the investors and a prospectus should be published, containing a full description of the proposed financial instruments. By 'selling to the public', the Central Bank means all marketing approaches, directly or indirectly, intended for a group of 20 or less persons.

Corporate Governance. As noted, only joint-stock companies are allowed to apply for the listing of their securities on the Beirut Stock Exchange.

Lebanese regulations stipulate that a specific provision must be included in the articles of incorporation of the issuing company, allowing the listing of its securities. Alternatively, and in the absence of such provision, a resolution by the general 'extraordinary' assembly of shareholders would be required.

The chairman of the board of directors must lodge the application for admission, after its approval by the board of directors. However, the need for prior approval by the company's general 'ordinary' assembly of shareholders will depend on the type of security to be listed, as follows:

- As to shares, the decision for the listing of shares falls within the competence of the board of directors, given the fact that it does not qualify as a 'day to day activity' falling, according to the Code of Commerce, within the President of the board of directors' competence;[10] and
- As to bonds, listing requires the approval by the board of directors and prior approval by the general 'ordinary' assembly.

In addition, in some cases, the decision of the general 'ordinary' assembly and the board of directors will not be sufficient. For instance, if the listing involves the modification of the company's capital, the approval of the general 'extraordinary' assembly of shareholders will be required.

Registration. There are no differences between the Official Market and the over-the-counter market with respect to the procedure for admission.

The application for admission of securities in the Official Market or Secondary Market is addressed to the Stock Exchange Committee by a broker appointed by the issuer to follow the listing procedures. The name of the broker must be indicated in the Briefing Memorandum that is delivered to the public. However, the broker may represent the issuer and inform the Stock Exchange whether he wishes subsequently to sign a cash-flow arrangement with the issuer.

The Stock Exchange Committee may refuse any security registration, even if the application was in due form and in compliance with all required terms. The Stock Exchange Committee also may postpone its decision concerning the application while reserving the right to reconsider it in case of changes in the issuing company's standing which may justify such act.

The Government Commissioner may object to a resolution of the Stock Exchange Committee if he deems such decision as being in breach of laws and regulations. The Government Commissioner must justify his objection and provide the Stock Exchange Committee with an explanation supporting his position. In this case, he may request that the Stock Exchange Committee reconsider its resolution, suspending its application and

10 Prior approval by the general 'ordinary' assembly is not required.

entry in force, or suspend its execution for one week, during which such resolution will be referred to the Ministry of Finance for final decision.

If a licence was granted, the Stock Exchange Committee must publish its resolution in the Beirut Stock Exchange *Official Bulletin*, and it must specify the terms of exchange as well as the first pricing of the listed securities. In addition, the issuer falls under the obligation to publish the above-mentioned Briefing Memorandum pertaining to his application file.

It is important to note that resolutions of the Stock Exchange Committee may be appealed before the Civil Chamber of the Court of Appeal of Beirut within 15 days as from the date when the concerned party was notified.

Any issuer who applies for a transfer from the Secondary Market to the Official Market must submit, through an appointed broker designated specifically for that purpose, a file including the following documents:

- An official letter of transfer, stating in details the motives of the issuer;
- A copy of the minutes of the general assembly authorising such transfer; and
- Any document, in general, that might update the file of the admission that was previously lodged.

The issuer must then publish in the Beirut Stock Exchange *Official Bulletin* a memorandum summarising the transfer's file.

Periodic Disclosure

Issuer's Reporting Duties

In General. Once the securities of the applying entity are admitted for listing either on the Official or the Secondary Markets, the issuer becomes subject to some reporting obligations, namely to:

- Provide the Stock Exchange Committee with all minutes of the meetings of the ordinary and extraordinary general assemblies and those of the boards of directors, which are lodged at the Secretary of the Trade Register within a delay of two weeks as per the day of deposit;
- Inform the Stock Exchange Committee and the public of any new element or development that may affect the financial situation or the activity of the issuer;
- Publish the budgets and the final annual consolidated accounts, as ratified by the general assembly in the Beirut Stock Exchange *Official Bulletin* within six months as per the day of closing the accounts;
- Publish the components of the financial results every six months in the Beirut Stock Exchange *Official Bulletin*; and
- Provide the Beirut Stock Exchange with all information and documents detailed hereinafter, whether relevant to the company or to any of its branches,[11] within 15 days

11 'Branch' is understood to encompass any joint-stock company that is owned by the issuer, directly or indirectly, by more than 50 per cent and that represents more than 10 per cent of the consolidated net value of the whole assets.

as from the date of publishing the documents or as from the date of their enforcement relating to (a) any fundamental change in the nature of the business carried out by the company, (b) any total or partial change in the management of the company, whether in respect of the general management or the board of directors, (c) any appointment of a new auditor for the company, (d) any sale or transfer of property of the issuer's company's assets if the transaction involves more than five per cent of the investment value in the Beirut Stock Exchange, and (e) anything that might affect, positively or negatively, the price of the issuer's securities.

If the issue involves bonds, the issuer is subject to an obligation of annual reporting as to the exact number of outstanding bonds.

Sanctions. In general, any issuer who fails to meet the regulatory requirements is subject to a wide range of sanctions that could vary from a simple warning or blame to a suspension, transfer from the Official Market to the Secondary Market, and even a possible cross-out.

In case of infringement of the above-mentioned reporting obligation, the issuer will be liable to a fine that is equivalent to two per cent of its capital.

Foreign Issuers with Secondary Admission

Every issuer, foreigner or Lebanese, who was previously admitted in the Official Market or Secondary Market and wishes to carry out an additional issue of its securities, must submit through its broker an additional admission application according to the procedures set by the Stock Exchange Committee. The application must include the following documents:

- A statement indicating the kind and value of the offered securities; and
- A copy of the minutes of the general assembly and the board of directors that specified the terms of the eventual transaction.

The Stock Exchange Committee may reject the above-mentioned application, even if it was in due form and in compliance with all required terms. The Stock Exchange Committee may postpone its decision in respect of the application reserving the right to reconsider it in case of any changes in the issuing company's standing, which may justify such act.

The admission of the application by the Stock Exchange Committee, along with the details of the transaction's procedures, must be published in the Beirut Stock Exchange *Official Bulletin*.

Trading Rules

Securities Offerings

Securities offerings at the Beirut Stock Exchange cannot take place unless all necessary steps are completed. This means that the issuer must first apply for his admittance and, in case of favourable decision, he must publish the above-mentioned Briefing Memorandum.

Since this procedure aims at protecting investors, any misrepresentation of information in the issuer's application would normally be sanctioned. Indeed, the Penal Code prohibits such acts.

Disclosure of Acquisition of Substantial Holdings

Every issuer is subject to an obligation of reporting any modification involving the number of votes entitled to any of the shareholders if he knew about it and such modification was more than:

- Two per cent for the general manager or the deputy general manager or a member of the board of directors; and
- Ten per cent for any other shareholder having, directly or indirectly, more than 10 per cent of voting rights in the company which securities are priced on the Beirut Stock Exchange.

In addition, the issuer must include in the by-laws of the company a clause limiting the voting rights to 10 per cent for every shareholder who had not previously declared to the board of directors that he has reached or exceeded the said percentage. The shareholder also must declare to the board any change over 10 per cent in respect of the number of voting rights.

Insider Trading and Fraud

Insider Trading. There are no specific requirements pertaining to insider trading in Lebanon. However, certain stipulations of the Penal Code would incriminate these acts and consider them similar to the French concept of *délit d'initié*.

Local courts may, under certain circumstances, address these issues and therefore render a judgment incriminating insider trading.

The new Capital Markets Draft Law addresses this issue and considers insider dealing as a special offence subject to a fine and criminal prosecutions.

Fraud. The Penal Code specifically prohibits the use of any fraudulent means that would lead, by any means, to influencing the functioning of the securities markets, ie, the spreading of false allegations and buying and selling with the intention of disrupting the market.[12]

Money Laundering. Parliament adopted the Fighting Money Laundering Law in 2001, and the Central Bank has played a major role in enforcing this law by issuing several Basic Circulars, primarily Basic Circular Number 7818 of 18 May 2001 regarding

12 Penal Code, art 685.

monitoring financial operations and fighting money laundering. The basic guidelines of the law and the Central Bank Circulars are:

- Financial institutions must certify and periodically verify the client's and the beneficiary's identities;[13] and
- Financial institutions must have an investigation committee and a compliance unit to prevent money laundering.

Public Take-Over Bids

It is important to note that regulations pertaining to take-over bids are very basic and simple. This is due to the fact that the Stock Exchange in Lebanon was closed during the civil war and that the size of the market is relatively small.

As mentioned above, the existing regulation provides for a straightforward procedure concerning take-over bids.

The procedure is initiated when an investor (or group of investors) wishes to own a bloc that is more than 10 per cent of the voting rights in a company which securities are priced in the official market or secondary market, or wishes to acquire the absolute or described majority in this company.

In this case, such investor must submit a draft of a public offer for purchase or exchange, through a broker, to the Stock Exchange Committee, with the following supporting documents:

- A description of his intentions in regard to the target company and the number of securities he owns, as well as the voting rights;
- The minimum and maximum number of securities and the voting rights that he wishes to acquire through this operation;
- The suggested price in cash and the terms of exchange; and
- An engagement not to breach the above-indicated terms along with the financial guarantees related thereto.

Once it has received the file and a decision is taken as far as the public offer, the Stock Exchange Committee will suspend the pricing of the security forming the object of the offer. Thereafter, the Stock Exchange Committee will issue its decision by approving or rejecting the terms of the offer. In case of approval, a statement will be published in the Beirut Stock Exchange *Official Bulletin*, indicating in details the terms of the operation. Once the decision of the Stock Exchange Committee is published, the security is re-priced according to ordinary rules.

If an investor or a group of other investors have submitted a counter offer, the offer may not be taken into consideration unless the counter-offered price is five per cent higher than the current price.

13 In case of any suspicion of money laundering, a financial institution must report the matter immediately to the Central Bank.

The offering party or his employees may not, within the period of his offer, and even until the final statement for closing of the offer, interfere directly or indirectly in the market of the company's securities, object of the offer and, in general, in any security market for any company indicated in the offer.

At the end of the offer period, the Stock Exchange Committee will publish the decision of the party that submitted the offer in the Beirut Stock Exchange *Official Bulletin* as to whether he intends to maintain or withdraw his offer. If he intends to withdraw his offer, the Stock Exchange Committee must set a date to return the securities to the investors. However, if he intends to maintain his offer, the Stock Exchange Committee shall determine the number of securities acquired by the offering party.

Jurisdictional Conflicts

Lebanon is not yet part of any multilateral or bilateral solutions to jurisdictional conflicts in international securities regulations, given the fact that the Lebanese market is relatively small and young.

However, it is important to note that Lebanese regulators, in an effort to facilitate foreign issuer access to the Lebanese market, are easing some of the admission and reporting requirements mentioned above. This policy is reflected in the fact that Lebanese regulations recognise other accounting standards with respect to financial statements and other documents provided they are equivalent to those required from Lebanese issuers.

Lithuania

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Lithuania

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Introduction

Legal Sources

The first steps in the regulation of the securities markets were made by the Lithuanian authorities in August 1992.[1] In principle, the initiative was part of Lithuania's overall movement towards the creation of essential modern market institutions. In particular, it was thought that it was time to reap the harvest of the original reform laws directed to create a free-market economy.

Since the adoption of the first privatisation laws in 1991, massive privatisation of state property has accelerated and has achieved relatively large volumes. At the aftermath of the opening of the National Stock Exchange of Lithuania (1 July 1993), currently the Vilnius Stock Exchange, 3,672 former state enterprises had been privatised; their total value was reported to be LTS 344.1 million.[2]

Vested with the framework of the first Companies Act of 1990,[3] privatisation created vast numbers of individuals increasingly owning small numbers of shares in privatised enterprises. As a result of this process, nearly 1.5 million Lithuanian residents (nearly 40 per cent of the population) became shareholders.[4] It was understood that the need had arisen for an effective and concentrated securities market that could be adequately supervised and regulated.

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1 Earlier attempts to address securities issues included Resolution Number 267 of 8 July 1991, Regarding Provisional Rules on Securities and Supplementary Settlement Documents, *Lietuvos Aidas* (13 July 1991), no 137; and Resolution Number 478 of 20 November 1991, Regarding Registration Procedure of the Securities Issued by Companies, *Zin* (1992), no 5-84.

2 'Basic Game Rules for Issuers', *Lietuvos Rytas* (22 April 1994), at p 8.

3 Companies Act of 30 July 1990, *Zin* (1990), no 24-594, later replaced by the Companies Act of 5 July 1994, *Zin* (1994), no 55-1046, which was further replaced by the Companies Act of 13 July 2000, *Zin* (2000), no 64-1914, and the Companies Act 2003 of 11 December 2003, *Zin* (2003), no 123-5574.

4 *National Stock Exchange of Lithuania* (1995), at p 3.

On 3 September 1992, the government adopted Resolution Number 646,[5] which launched the securities market and its supervisory authority in Lithuania. Without approaching the legal or regulatory aspects of securities transactions, Resolution Number 646 merely set out a few provisions regarding the procedure for the establishment of the National Stock Exchange and approved the statutes (in particular, functions and organisation) of the Securities Commission.[6]

On 30 October 1992, the government adopted Resolution Number 815, the Temporary Provisions on Issue and Public Trading in Securities and a Stock Exchange.[7] It was the basic legal source governing them until the adoption of the Public Trading in Securities Act in 1996. In particular, Resolution Number 815:

- Defined the meaning of a security;[8]
- Established the requirement of the prior registration of an issue of securities with the Securities Commission and laid down procedural rules for registration;[9]
- Set out several provisions on a primary transfer of securities, such as prohibition to advertise securities prior to registration;[10]
- Established the requirement of, and the procedure for, the prior authorisation of intermediaries, defined their activities, and fixed some rules of conduct;[11] and
- Described a stock exchange, its functions, organisation, and membership, and introduced some principal rules on the trade and the listing of securities on an exchange.[12]

On 20 May 1993, Resolution Number 815 was amended[13] with a view to introducing the book-entry trading system and the concept of dematerialised securities. Amendments laid down the principles of setting up and defining the functions of the Central Depository of Lithuania, as well as the principles of accounting for securities and securities transactions.

The Resolutions had been intended to be an initial and provisional substitute for the solid legal framework of the securities market. Loosely drafted, in ignorance

5 Resolution Number 646 of 3 August 1992; *Zin* (1992), no 29-876, as amended.
6 Resolution Number 499, *Zin* (1992), no 25-753, but functions of the Commission were not specified there.
7 *Zin* (1992), no 34-1045, as amended; *Zin* (1993), no 3-64; *Zin* (1993), no 17-444; hereinafter Resolution Number 815.
8 Resolution Number 815, art 2.
9 Resolution Number 815, arts 8–20.
10 Resolution Number 815, arts 21–23.
11 Resolution Number 815, arts 24–44.
12 Resolution Number 815, arts 45–123.
13 Resolution Number 352 of 20 May 1993, amending Resolution Number 815 of 30 October 1992, *Zin* (1993), no 17-444.

of the wider consequences of their effect, some of their provisions interfered with essential legal concepts[14] and provisions of other laws.[15]

On 16 January 1996, the main statutory instrument regulating securities in Lithuania was adopted, the Public Trading of Securities Act.[16] Although it was largely based on earlier rules, it also introduced some innovations. In particular, it expressly spelled out objectives of the law (and, hence, regulation) with reference to the safety, transparency, and efficiency of the market to protect the interests of investors and ensure competition between market participants.[17]

The Public Trading in Securities Act has liberalised the regulatory regime (eg, by implying the possibility of the over-the-counter market), but rules on reporting and disclosure have been made stricter (eg, disclosure of the acquisition or disposition of the qualifying holdings, and reporting of the material events). The Act also introduced rules on mandatory tender offers and insider dealing, as well as the concepts of investment management and consulting firms. The Public Trading in Securities Act has made the Securities Commission independent of the government, has increased its powers, and has introduced the concept of liability for breaches of the regulatory regime.[18]

The Public Trading in Securities Act was significantly revised on 19 March 1998.[19] Further, on 17 December 2001, Parliament adopted a new version of the law with the new title 'Securities Market Act',[20] effective as of 1 April 2002 (except for the EU single passport for securities firms provisions).

The main purpose of the reform was to finalise the implementation of the European Union (EU) Directives in the field, harmonise the legislation with the IOSCO Objectives and Principles of Securities Regulation and with the New Lithuanian Civil Code which took effect on 1 July 2001,[21] as well as, as stated in the Explanatory Submission to the Parliament, to reflect the modern trends in the globalisation of the investment services fields and convergence of securities markets.

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14 For example, any transfer of securities was formally described as public trading and subject to the same regulatory regime. It appears that, in practice, this provision was disregarded.

15 For example, the provisions established the grounds for invalidation of transactions which, according to legal doctrine, is the sole domain of legislation.

16 *Zin* (1996), no 16-472.

17 Public Trading in Securities Act, art 1.

18 Although the final determination in the preparation of the draft was for the Securities Commission, initial drafts were prepared by the Technical Assistance Mission consisting of the French experts working under the European Union PHARE programme (hereinafter 'French Draft'). Final Report on the Technical Assistance Mission for the Lithuanian Securities Commission, Commission of the European Communities, 31 December 1993.

19 *Zin* (1998), no 33-873.

20 *Zin* (2001), no 112-4074.

21 Civil Code of the Republic of Lithuania of 18 July 2000, *Zin* (2000), no 74-2262.

The Securities Market Act revised the objectives of the law by placing an emphasis on the principles of fair, transparent, and effective securities markets, as well as investor protection and introducing new objective protection against systemic risk.[22]

A significant movement towards the recognition of the international nature of the securities markets is noticeable in the Act. The Act, for the first time, introduced a long-awaited delineation of the territorial scope of its application. Thus, for example, the share would be registered with the Lithuanian Securities Commission if the issuer is a company (as described in more detail later) of the Republic of Lithuania; or a person intends to publicly offer the securities in the Republic of Lithuania.[23] The licensing function of the Lithuanian Securities Commission was limited to the companies registered in the Republic of Lithuania.[24] The Act laid down conditions upon which a Lithuania-based securities firm could provide investment services abroad.[25]

Secondly, the Securities Market Act introduced single passport provisions for the EU securities firms,[26] which became effective upon Lithuania joining the EU.[27] Following the concept established by the Investment Services Directive,[28] an attempt was made to divide the supervisory rules applicable to investment firms into the so-called prudential rules[29] and rules of conduct.[30] With respect to the cross-border activities of investment firms, the Securities Market Act established the principle of home country control of Lithuanian investment firms in terms of drawing up and enforcement of prudential rules[31] and the principle of host country control of the foreign investment firms in terms of rules of conduct.[32]

Finally, in the field of international co-operation, the Securities Market Act introduced channels of communication for the exchange of information between Lithuanian supervisors and those of EU member states, as well as those of other countries on the basis of mutual co-operation agreements.[33]

Some reformatory changes were made in the field of trading rules and prospectus requirements. The offer of securities through an intermediary was not an element qualifying the concept of a public trading in securities[34] anymore.

22 Securities Market Act, art 1.
23 Securities Market Act, art 4.2.
24 As well as firms not licensed in EU member states.
25 Securities Market Act, art 30.
26 Securities Market Act, art 23.
27 Securities Market Act, art 64.2.
28 Council Directive of 10 May 1993 on investment services in the securities field (93/22/EEC), OJ 1993 L 141/270, later repealed by Directive 2004/39/EC.
29 Securities Market Act, art 24.1.
30 Securities Market Act, art 24.3.
31 Securities Market Act, art 35.
32 Securities Market Act, art 36.
33 Securities Market Act, art 57.
34 Securities Market Act, art 2.30.

Hence, the mere fact of an offer of securities through an intermediary does not invoke the requirement of registration of securities with the Commission. In the original version of the draft Securities Market Act, a proposal was made to discard the market concentration principle: a prohibition of over-the-counter trades in listed securities. However, when the bill was going through the parliament, the proposal was rejected. Consequently, the sale and purchase transactions with listed securities still need to be carried out on the stock exchange.[35]

The Securities Market Act continued to use the Lithuanian concept of registration of securities rather than registration of the prospectus for the purposes of public offering. To avoid unnecessary private law consequences experienced in the legal practice in the past, an attempt was made in the Act to clarify this concept so that such registration means a registration of the issue of securities rather than registration of particular securities.

The Securities Market Act draftsmen found the long-existing prospectus registration requirement with respect to any issues as impracticable and cumbersome. A reference was made to EU Directives, such as the Selling Prospectus Directive[36] and Listing Particulars Directive,[37] providing exemptions from such registration requirements, as well as the EU mutual recognition of the European prospectuses. Accordingly, the revised legislation then authorised the Lithuanian Securities Commission to set out the rules when the registration of the securities was not required,[38] when the registration could have been granted without the submission of the prospectus, as well as registration rules where the prospectus had been scrutinised by the competent authorities of the EU member states.[39]

The Securities Market Act significantly revised the definition of the security by dividing it among the lines of the Investment Services Directive into two concepts: securities and investment instruments.[40] Regulatory rules applied to these two categories to a different extent; thus trading rules, prospectus, disclosure and reporting requirements, rules on acquisition of qualifying holdings, and tender offers applied to securities in the strict sense, whereas the rules applicable to the intermediaries, stock exchanges, the Securities Commission, and liability for contraventions applied in connection with both securities and investment instruments.[41]

35 Securities Market Act, art 14.2.

36 Council Directive of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny, and distribution of the prospectus to be published when transferable securities are offered to the public (89/298/EEC), OJ 1989 No L 124/8.

37 Council Directive of 17 March 1980 coordinating the requirements for the drawing-up, scrutiny, and distribution of listing particulars to be published for the admission of securities to the official stock exchange listing (80/390/EEC), OJ 1980 No L 100/1.

38 Securities Market Act, art 4.3.

39 Securities Market Act, art 6.9.

40 Securities Market Act, art 3.

41 Securities Market Act, art 3.3.

In addition, the Securities Market Act:

- Reduced the threshold triggering the mandatory tender offer from 50 per cent to 40 per cent shareholding and modified the mandatory tender offer pricing mechanism (weighted average price paid over the last 12 months was replaced by the highest price paid);[42]
- Introduced the concept of investment services,[43] defining them in line with the Investment Services Directive, and the licence requirement for provision of such services;[44]
- Slightly revised the rules on reporting of acquisition/disposal of qualifying holdings[45] to make them more compatible with the Transparency Directive;[46]
- Revised the rules on insider dealing[47] to make them more compatible with the Insider Dealing Directive;[48]
- Eliminated the difference between financial brokerage firms and investment management and consulting firms and introduced single conditions for authorisation;
- Revised the conditions for authorisation of investment firms (eg, introduced requirements of 'fit and proper' owners, and the like);[49]
- Introduced an obligation of auditors of an investment firm to report contravention of regulatory standards;[50] and
- Since 1 January 2005, implemented rules as to squeeze-outs and mandatory sell-outs.[51]

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42 Securities Market Act, art 19.

43 Securities Market Act, art 2.11.

44 Securities Market Act, art 20.1.

45 Securities Market Act, arts 15 and 16.

46 Council Directive of 12 December 1988 on the information to be published when a major holding in a listed company is acquired or disposed of (88/627/EEC), OJ 1988 L 348/62, as incorporated in Directive of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities (2001/34/EC), OJ 2001 L 184/1.

47 Securities Market Act, art 9.

48 Council Directive of 13 November 1989 coordinating regulations on insider dealing (89/592/EEC), OJ 1989 L 334/30, later repealed by Directive 2003/6/EC.

49 Securities Market Act, art 26.

50 Securities Market Act, art 29; see also the so-called post BCCI Directive: European Parliament and Council Directive 95/26/EC of 29 June 1995, amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non-life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms, and Directive 85/611/EEC in the field of undertakings for collective investment in transferable securities (ucits), with a view to reinforcing prudential supervision, OJ 1995 L 168/7 (amended by Directive 2009/65/EC).

51 Securities Market Act, art 19(1).

Apart from legislation, other legal regulatory sources in the securities field include regulations passed by the Securities Commission, the Central Depository, and the Vilnius Stock Exchange. The regulations of the Securities Commission deal with matters such as:

- Public offers of securities and prospectus requirements;[52]
- Insider dealing;[53]
- Tender offers;[54]
- Reporting;[55]
- Licensing of intermediaries;[56] and
- Capital adequacy.[57]

Most of the regulations adopted by the Securities Commission implement EU Directives in the field. Additionally, certain legislative initiatives aimed at approximation of Lithuanian laws with EU legal requirements demonstrate the trend of the unification of the regulatory regime applicable to different types of financial services and their providers.

In particular, on 10 September 2002, Parliament adopted the Financial Institutions Act,[58] which came into effect on 1 July 2003 (except for provisions relating to the EU single passport for credit and financial institutions, as well as provisions excluding the application of the financial institutions' regulatory regime for undertakings rendering services listed in items 8–9 of Annex I of Directive 2000/12/EC,[59] which came into effect on 1 May 2004).

52 Rules on Securities Prospectus and Information Disclosure, approved by Resolution of the Securities Commission on 15 July 2005, in effect as from 29 July 2005, *Zin* (2005), no 91-3420.

53 Rules on Disclosure of Material Events Relating to Issuers, approved by the Resolution of the Securities Commission on 9 March 2001, in effect as from 22 March 2001, *Zin* (2001), no 24-814 (put into new wording by the Resolution of the Board of the Bank of Lithuania on 28 February 2013, in effect as from 9 March 2013, *Zin* (2013), no 25-1253).

54 Rules on Submission, Registration and Implementation of a Tender Offer, approved by the Resolution of the Securities Commission on 12 April 2002, in effect as from 9 May 2002, *Zin* (2006), no 80-3185.

55 Rules on Securities Prospectus and Information Disclosure, approved by Resolution of the Securities Commission on 15 July 2005, in effect as from 29 July 2005, *Zin* (2005), no 91-3420.

56 Rules on Issuing and Withdrawal of Licences to Financial Brokerage Enterprises, approved by the Resolution of the Securities Commission on 30 October 2007, in effect as from 11 November 2007, *Zin* (2007), no 115-4740.

57 Regulation on Capital Adequacy Requirements for a Licensed Financial Brokerage Firms and Securities Management Companies, approved by Resolution of the Securities Commission on 22 March 2007, in effect as from 1 January 2008, *Zin* (2007), no 36-1349.

58 Financial Institutions Act of 10 September 2002, *Zin* (2002), no 91-3891, as amended.

59 Directive of the European Parliament and of the Council of 20 March 2000 relating to

As stated in the Explanatory Submission to the Parliament, the main purpose of the Financial Institutions Act is to define financial services, to determine requirements for the founders, participants, and directors of financial institutions and the incorporation, carrying out, termination, and restructuring of activities of financial institutions, as well as to lay down the rules for the supervision of financial institutions rendering licensed financial services.

The Financial Institutions Act sets out the same conditions on which a Lithuania-based financial institution may provide financial services in the EU member states,[60] as it was prescribed by the Securities Market Act.[61] Furthermore, both Acts contained identical single passport provisions for the EU financial institutions,[62] due to come into force on Lithuania joining the EU.[63] However, with regard to cross-border activities, the Financial Institutions Act does not clearly stipulate the principle of home country prudential supervision.[64] The Act provides that instruments of prudential supervision enshrined in Lithuanian laws are applicable to financial institutions.[65] By definition it includes Lithuanian enterprises and subdivisions of foreign enterprises rendering financial services in Lithuania.[66] Thus, it remains to be seen if a host country's prudential supervision applies to branches of foreign financial institutions. It is quite obvious that regulatory acts implementing the Financial Institutions Act, together with the Law on Banks and new Securities Law, rectify the inconsistency.

In general, the list of activities within the definition of financial services under the Financial Institutions Act[67] reflects the provisions of Directive 2000/12/EC.[68] However, the regulatory consequences from certain services being included in the list are subject to criticism.

First, the Financial Institutions Act automatically applies the financial institutions regime to any undertaking rendering services which are included in the financial services list, provided that such an undertaking renders said services in accordance with its corporate documents and the 'main portion' of its income is derived from such services.[69] The Act fails to exempt from its regulatory regime undertakings to which supervisory requirements in the field of investment services are not applicable pursuant to the Securities Market Act[70]

the taking up and pursuit of the business of credit institutions (2000/12/EC), OJ 2000 L 126/1, as amended by Directive 2000/28/EC.

60 Financial Institutions Act, art 39.

61 Securities Market Act, art 30.

62 Financial Institutions Act, art 12; Securities Market Act, art 23.

63 Financial Institutions Act, art 58.4.

64 Financial Institutions Act, chs 7 and 8.

65 Financial Institutions Act, chs 7 and 8.

66 Financial Institutions Act, arts 2.7, 2.23, and 4.1.

67 Financial Institutions Act, art 3.1.

68 Directive 2000/12/EC, Annex I.

69 Financial Institutions Act, arts 4.1 and 2.43.

70 Securities Market Act, art 20.3.

and the Investment Services Directive.[71] Therefore, it seems that the Financial Institutions Act attempts to debar persons of regulated professions (such as auditors, attorneys at law, notaries, and the like) from rendering consultancy services relating to mergers and acquisitions.[72] On the other hand, the Act does not include insurance services in the financial services list, thus debatably excluding insurance undertakings from the regulatory regime applicable to financial institutions.[73]

Notably, the Lithuanian Securities Commission some time ago prepared the initial draft amendments to the Securities Market Act aimed at co-ordination of provisions of the Securities Market Act with the Financial Institutions Act.[74] However, the draft amendments to the Securities Market Act left the exceptions from licensing requirements to persons rendering investment services as part of their regulated professional activity, as well as to other undertakings specified in the Investment Services Directive,[75] untouched. Thus, it may be implied that the Financial Institutions Act should be interpreted in the light of the exemptions stipulated in the Securities Market Act (currently the Securities Act). Nevertheless, the actual consequences of the unified regulatory concept introduced by the Financial Institutions Act remain unclear.

Furthermore, the Financial Institutions Act applies basically the same legal requirements to all undertakings rendering financial services as to credit institutions. Thus, the Financial Institutions Act implies the necessity to revise certain other legal acts governing separate types of financial activities including the Securities Act. The amendments to the Securities Market Act, as prepared by the Lithuanian Securities Commission, mainly intended to introduce certain additional management-related provisions:

- Compulsory management bodies of securities firms are supplemented by the administration in addition to the board;[76]

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71 Directive 93/22/EEC, art 2.2.

72 Financial Institutions Act, arts 3.1.16 and 3.1.17; notably, the Financial Institutions Act provides that undertakings rendering only the services listed in arts 3.1.16 and 3.1.17 are not considered as financial institutions prior to Lithuania joining the EU.

73 See the so-called post BCCI Directive: European Parliament and Council Directive 95/26/EC of 29 June 1995, amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non-life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms, and Directive 85/611/EEC in the field of undertakings for collective investment in transferable securities (*ucits*), with a view to reinforcing prudential supervision, OJ 1995 L 168/7, as amended by Directive 2009/65/EC.

74 Law on Amendments and Supplements to arts 1–3, 8–11, 15–17, 19–20, 23, 26–27, 29, 36, 41, 48, 51–52, 57, 59, and 65 of the Securities Market Act; 30 April 2004, *Zin* (2004), no 73-2514.

75 Directive 93/22/EEC, art 2.2.

76 Financial Institutions Act, art 19; notably, the Financial Institutions Act provides for a mandatory position of the deputy to the head of the administration, who will act

- Regulation of audit of securities firms, as well as duties of auditors of securities firms, is delegated to the Audit Act[77] and the Financial Institutions Act;
- Definition of the director of a securities firm, stock exchange, and central depository is referred to the Financial Institutions Act;[78] and
- General permission to render investment services in foreign currency is provided,[79] although its compatibility with the Foreign Currency Act[80] is debatable due to the fact that the Foreign Currency Act authorises settlements in foreign currency (other than in Euros) only in non-cash payments.[81]

Additionally, the amendments to the Securities Market Act reflected the recommendations of the EU expert 'peer review' mission, as well as comments of the European Commission experts with respect to the compatibility of the Securities Market Act with the EU legal acts. It is thus intended to:

- Add a threshold of five per cent triggering the obligation to notify the supervisory authority of the acquisition or disposal of the qualified holding;
- Revise the rules on reporting of the issuers' directors' transactions relating to the securities of the issuer by stipulating that information on such transactions is to be disclosed publicly;
- Unify the requirements applicable to directors of securities firms, stock exchanges, and central depositories;
- Repeal the statutory presumption that the acquisition of treasury shares by a listed company may not be considered as market manipulation;
- Provide rules for the calculation of the mandatory tender offer price when shares have been acquired free of charge;
- To stimulate voluntary tender offers, provide the obligation to refund persons having accepted a tender offer the balance between the price of securities acquired in one year after the implementation of the tender offer and the tender offer price only in the case of a mandatory tender offer; and
- Authorise the securities market supervisory authority to publicly disclose information which may be necessary for the protection of market interests.

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jointly with the head of the administration in certain areas of activity prescribed by the corporate documents of a financial institution; furthermore, the Act may possibly be interpreted as requiring the formation of a supervisory council as well.

77 Audit Act of 15 June 1999, *Zin* (1999), no 59-1916, as amended.

78 Financial Institutions Act, art 20.1.

79 Financial Institutions Act, art 3.5.

80 Foreign Currency Act of 7 July 1999, *Zin* (1993) no 28-640, as amended.

81 Foreign Currency Act, art 3; notably, Euros may be used in both cash and non-cash transactions.

On 20 June 2002, the Deposit and Investor Liabilities Insurance Act was adopted and came into effect on 1 July 2002.[82] The Act incorporated the Deposit Insurance Act[83] and the Investor Liabilities of Commercial Banks and Financial Brokerage Firms Insurance Act,[84] and aimed at implementing the Deposit Guarantee Directive[85] and the Investor Compensation Directive.[86] The Act provides for a single deposit and investor-compensation scheme consisting of the Deposit Insurance Fund and the Investor Liabilities Insurance Fund administered by the State Enterprise Deposit and Investment Insurance.[87]

Pursuant to the Act, only Lithuania-based credit institutions and investment firms, as well as branches of foreign credit institutions and investment firms not belonging to a deposit/investor compensation scheme in their home country or belonging to a scheme which does not offer protection equivalent to that prescribed by the Act, must belong to the compensation scheme provided in the Act.[88] Hence, the Act implements the principle of prudential supervision with respect to investment firms and credit institutions in line with Directive 97/9/EC and Directive 94/14/EC.

The maximum coverage and the percentage of coverage is as follows: (1) for deposits: 100 per cent of the deposit not exceeding the equivalent of €100,000; (2) for obligations to investors: 100 per cent of the obligation to investors (securities and/or cash) of up to €3,000 and 90 per cent of the obligation to investors (securities and/or cash) within the range of €3,000 to €22,000.[89]

The Collective Investment Undertakings Act[90] aims at implementing the UCITS Directive.[91] As specified in the Explanatory Submission to the

82 Deposit and Investor Liabilities Insurance Act of 20 June 2002, *Zin* (2002), no 65-2635.

83 Deposit Insurance Act of 27 February 2001, *Zin* (2001), no 23-760.

84 Investor Liabilities of Commercial Banks and Financial Brokerage Firms Insurance Act of 17 December 2001, *Zin* (2001), no 112-4073.

85 Directive of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes (97/9/EC), OJ 1997 L 084/22.

86 Directive of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes (94/19/EC), OJ 1994 J 135/5, as amended by Directive 2009/14/EC.

87 The Deposit and Investor Liabilities Insurance Act, art 20.2. Notably, pursuant to Resolution Number 14 of the Securities Commission of the Republic of Lithuania as of 4 May 2000, *Zin* (2000), no 39-1113, a separate Guarantee Fund is formed within the National Stock Exchange of Lithuania for the purpose of ensuring the completion of central market transactions, so that member firms of the National Stock Exchange received securities and payment in the central market transactions where they act as intermediaries or on their own behalf.

88 Deposit and Investor Liabilities Insurance Act, art 4.

89 Deposit and Investor Liabilities Insurance Act, art 5.

90 Collective Investment Undertakings Act, 25 July 2003, *Zin* (2003), no 74-3424.

91 Council Directive of 20 December 1985 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (85/611/EEC), OJ 1985 L 375/3, Commission

Parliament, it is intended to supplement the earlier collective investment scheme, which comprised investment companies only, by introducing the concept of investment funds.[92] Accordingly, the Securities Market Act was changed to reflect the conceptual change, ie, the replacement of the term, 'investment companies' by the terms 'collective investment undertakings' and 'investment funds'.

The Settlement Finality in Payment and Securities Settlement Systems Act[93] implemented the Settlement Finality Directive.[94] The Settlement Finality Act seeks to ensure the safe and reliable functioning of payment and securities settlement systems, reduce system risks, secure the interests of participants in a system in case of insolvency and bankruptcy (restructuring) proceedings against a participant to such system, as well as to secure the interests of the central banks prescribed in the Act.

The Settlement Finality Act[95] lays down legal requirements for the proper operation of each system. Firstly, the Act requires registration with the Bank of Lithuania of the payment and securities settlement systems, which are, by the choice of participants in such systems, governed by Lithuanian law. The Act further requires each system to have its operator responsible for the safe and effective functioning of that system.

Only the Bank of Lithuania, the Central Depository of Lithuania, a Lithuanian or EU/EFTA member state's financial institution (or its subsidiary), or an operator of a system which is governed by the laws of Lithuania or of the EU/EFTA member state may be appointed as an operator of a system.[96] Each system operates under the rules of that system adopted in accordance with the Act.[97]

The Act incorporates provisions of the Settlement Finality Directive aiming to minimise the disruption to a system caused by insolvency proceedings against a participant in that system, and stipulates the principle of priority of the settlement of the participant's liabilities arising out of his participation in a system over any other liabilities prescribed by the law.[98] The Act also stipulates provisions insulating collateral security from the effects of the applicable

Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC.

92 Explanatory Submission on the Draft Law on Collective Investment Undertakings, at http://www3.lrs.lt.

93 Settlement Finality in Payment and Securities Settlement Systems Act, 1 July 2003, *Zin* (2003), no 61-2754.

94 Directive of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (98/26/EC), OJ 1998 L 166/45, as amended by Directive 2009/44/EC.

95 Settlement Finality Act of 5 June 2003, *Zin* (2003), no 61-2754, as amended.

96 Settlement Finality Act, art 4.

97 Settlement Finality Act, art 4.3.

98 Settlement Finality Act, art 7.2.

insolvency law in line with the Settlement Finality Directive[99] and lays down certain rules on the applicable law.[100]

However, the proper implementation of the Settlement Finality Act was subject to the adoption of a law governing financial collateral arrangements in line with Directive 2002/47/EC.[101] The Act came into effect on 1 May 2004.[102]

Other main EU Directives, including the Directive on Insider Dealing and Market Manipulation (Market Abuse),[103] were implemented into national legislation by way of amending the Securities Market Act and issuing other new acts.

On 18 January 2007, the former Securities Market Act was replaced by two new laws: the Securities Act[104] came into effect on 8 February 2008, and the Financial Instruments Markets Act came into effect on 8 February 2008.[105] Following adoption of the new laws, the Securities Commission issued a number of consorted legal acts determining rights and duties of the issuers and relations of securities market participants. The new laws and the subordinate legislation are the outcome of final implementation of the EU Takeovers, Transparency, and Markets in Financial Instruments Directives. The new laws finally introduce a new disclosure system and requirements, expand the scope of the publishable information, and regulate the access to information at the EU level.

Following a series of legislative revisions, as from 1 January 2012, the competent supervisory authority with regard to securities and their markets is the Bank of Lithuania, which took over the functions of the Securities Commission. The Bank of Lithuania is in the process of revising and releasing new wordings of previous Resolutions of the Securities Commission regarding such matters as public offers of securities, prospectus requirements and reporting,[106] tender offers,[107] licencing of intermediaries,[108] and others. These

99 Settlement Finality Act, art 9.

100 Settlement Finality Act, arts 8.5 and 8.6.

101 Directive of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (2002/47/EC), OJ 2002 L168/43, as amended by Directive 2009/44/EC.

102 Financial Collateral Arrangements Act, *Zin* (2004), no 61-2183.

103 Directive of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (2003/6/EC), OJ 2003 L 96/16, as amended.

104 Securities Act, no X-1023, *Zin* (2007), no 17-626.

105 Financial Instrument Markets Act, no X-1024, *Zin* (2007), no 17-627.

106 Rules on Securities Prospectus and Information Disclosure, approved by the Resolution of the Board of the Bank of Lithuania on 28 February 2013, in effect as from 9 March 201, *Zin* (2013), no 25-1251.

107 Rules on preparation and approval of a circular, and implementation of a Tender Offer, approved by the Resolution of the Board of the Bank of Lithuania on 28 February in effect as from 9 March 2013, *Zin* (2013), no 25-1254.

108 Rules on Issuing of Licences to Financial Brokerage Enterprises, approved by the Resolution of the Board of the Bank of Lithuania on 13 December 2012, in effect as from 22 December 2012, *Zin* (2012), no 151-7755.

new versions have been adopted to correlate to the changed supervisory regime under the rule of the Bank of Lithuania.

An incentive to finance small and medium-sized businesses was presented with the introduction of the Collective Investment Undertakings Intended for Informed Investors Act.[109] The Act allowed the functioning of investment undertakings managing funds through partnerships instead of a joint stock or close joint stock companies. Broader choices as to investment possibilities and the diversification of risks were also introduced resulting in an overall more flexible legal regulation as to the activities of collective investment undertakings.

Authorities

Bank of Lithuania (Supervisory Department of Bank of Lithuania)

The Securities Commission of Lithuania was the major regulatory and supervisory authority with respect to securities and their markets up until legislative revisions that took part in the end of year 2011. Its functions have been overtaken by the Supervisory Department of the Bank of Lithuania. The Financial Instruments Markets Act provides that markets in financial instruments shall be regulated and supervised by the Bank of Lithuania.

A newly established unit of the Bank of Lithuania, the Supervisory Department, oversees commercial banks and other credit and payment institutions, securities and insurance markets, and investigates disputes between consumers and financial institutions. The Supervisory Department was authorised by the Board of the Bank of Lithuania to carry out almost the entirety of supervisory functions, with certain exceptions as to licensing and enforcement measures of banks, branches of foreign banks, insurance undertakings, credit unions, and others.[110] These functions are still vested with the Board of the Bank of Lithuania. The main functions of the Bank of Lithuania in the ambit of its supervisory authority regarding markets in financial instruments include:

- Adoption of regulations on authorisation and activities of intermediaries and stock exchanges and the issues of securities and trading in them;
- Approval of the forms of prospectuses and other disclosure documents and determination of the procedure for the submission and publication of those documents;
- Issuance of official interpretations and recommendations on the matters of trading in securities;
- Authorisation of intermediaries and exchanges;

109 Collective Investment Undertakings Intended for Informed Investors Act, no XII-376, *Zin* (2013) no 68-3410.

110 Resolution of the Board of the Bank of Lithuania on 15 March 2013 in effect as from 23 March 2013, *Zin* (2012), no 34-1693.

- Supervision of intermediaries, stock exchanges, and the Central Depository; and
- Application of sanctions for contravention of the Securities Act and other regulatory rules.[111]

After combining all the provisions of the Markets in Financial Instruments Act, it is clear that the Bank of Lithuania is essentially authorised to determine more detailed rules, but not to modify rules laid down by legislation. However, the Bank of Lithuania is, under the circumstances expressly stated in the Securities Act, authorised to lay down exceptions to certain rules prescribed by the Securities Act.

By the 1998 revision of the Public Trading in Securities Act, the Securities Commission has arguably been granted a power to file class actions, ie, 'to bring an action to court regarding protection of the rights of investors, if interests of many investors have been violated' by issuers, intermediaries, or other entities.[112] Such right of the Securities Commission has been slightly modified by virtue of the Securities Market Act, which authorised the Securities Commission to file an action on behalf of investors for the protection of public interest only. This right is now granted to the Bank of Lithuania.[113] As defined in the Commentary to the Lithuanian Civil Code, public interest means a benefit to the society or a part thereof, as well as common welfare. Public interest may also include group interests.[114]

The Securities Market Act, and later the Financial Instruments Markets Act has further extended the scope of the Securities Commission's (now the Bank of Lithuania) cross-border activities by granting powers to make arrangements with appropriate foreign authorities for the purpose of co-operation and exchange of information,[115] as well as for certain supervisory activities with regard to the branches of Lithuania-based investment firms.[116]

Central Depository

The Central Depository of Lithuania is the inseparable part of the Lithuanian system of dematerialised securities and its market. The Central Depository of Lithuania is a stock company established by the Ministry of Finance, the Bank of Lithuania, and the Vilnius Stock Exchange.

Only the Republic of Lithuania, the Bank of Lithuania, credit institutions registered in the Republic of Lithuania or other Member State, financial brokerage firms, insurance undertakings, investment companies with variable

111 Financial Instruments Markets Act, art 70.2.
112 Public Trading in Securities Act, art 32.2(9).
113 Financial Instruments Markets Act, art 71.
114 *Commentary to the Civil Code of the Republic of Lithuania* (2002), Book II, at p 98.
115 Financial Instruments Markets Act, arts 70.2 and 74–80.
116 Financial Instruments Markets Act, arts 89–90.

capital and investment fund management companies, pension fund management companies, operators of a regulated market, central depositories, and central counter parties.[117]

The functions of the Central Depository of Lithuania include adoption of regulations on the bookkeeping and accounting of securities and laying down details for separate procedures provided for by the general accounting rules. By Resolution Number 03-161 of 12 July 2012, the Bank of Lithuania approved Rules on Accounting of Financial Instruments and Transactions (the "2012 Accounting Rules"), which took effect as of 22 July 2012. The Central Depository of Lithuania must control compliance by account operators with the securities accounting rules and regulations.

The 2012 Accounting Rules set forth principles for accounting of securities and for circulation of such securities. All such accounting in Lithuania is to be conducted by the Central Depository and account managers in a two-tier securities accounting system, of which (i) the first tier includes general (omnibus) securities accounts opened and managed by the Central Securities Depository, also securities issue accounts registered with the Central Securities Depository, and accounts of foreign securities depositories for accounting of securities of clients/participants of these foreign securities depositories, as well as personal accounts opened in the name of the Bank of Lithuania and accounts for pledged securities to the European Central Bank or Central Bank of EU Member States as well as securities allocated for the repo transactions with those latest subjects; and (ii) the second tier comprises personal accounts opened in the name of the securities owner or holder of financial collateral (without transfer of title), or pledges. In case the securities broker acquires securities abroad in its name but for the client's cash, the securities broker is obliged to open a personal securities account in the name of the owner (client) as soon as confirmation of securities acquisition is received.

All securities accounting operations are based on the delivery versus payment principle. The Central Depository of Lithuania must ensure timely clearing of the securities transactions between different account operators and control the circulation of registered securities.[118] It is explicitly provided by the Financial Instruments Markets Act that the regulations and orders of the Central Depository of Lithuania in this area are mandatory for all account operators.

Stock Exchange

The Vilnius Stock Exchange of Lithuania (the former National Stock Exchange) is the only stock exchange in Lithuania. It was established pursuant to Resolution Number 646, and it was registered with the Securities Commission on 11 May 1993. The first trading session took place on 14 September 1993. At

117 Financial Instruments Markets Act, art 67.3.
118 Financial Instruments Markets Act, art 68.1.

that time, 19 issuers were listed on its current trading list.[119] The Stock Exchange model initially was based on that of the French exchanges. It has been implemented in close cooperation with the Paris Bourse.[120]

Pursuant to the Financial Instruments Markets Act,[121] the Stock Exchange is a specialised stock company. An entity may operate as a securities exchange only with prior authorisation by the Bank of Lithuania.

Historically, the Public Trading in Securities Act limited the right of entities other than the Central Bank and the Ministry of Finance to hold more than five per cent of votes in the general meeting of an exchange.[122] Furthermore, the Public Trading in Securities Act made the establishment of stock exchanges subject to a resolution of the government.[123]

By revoking the requirement of the government authorisation, as well as restrictions on the holdings in an exchange,[124] the Securities Market Act (which was replaced by the Financial Instruments Markets Act) has thus removed the main legal obstacles for setting up other stock exchanges besides the Vilnius Stock Exchange of Lithuania. However, as a practical matter, no other stock exchanges yet operate in Lithuania.

Starting from 30 May 2005, the Vilnius Stock Exchange became a member of OMX group, together with stock exchanges in Copenhagen, Helsinki, Riga, Stockholm, and Tallinn. OMX, operating in three Baltic States (Estonia, Latvia, and Lithuania), offers a single list of securities in trade at the same time implementing a safe and smooth trade measure under the best trade practice in stock exchanges. Pursuant to the Financial Instruments Markets Act, a stock exchange is obliged to:

- Organize trade in securities, and their listing, quotation, and safe and efficient transactions and settlements;
- Promote fair trading in securities and prevent manipulation of prices and other unfair actions;
- Publish unified information on listed securities and transactions; and
- Ensure the protection of confidential information and carry out internal control.[125]

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119 *National Stock Exchange of Lithuania* (1995), at p 4.

120 'The Stock Exchange: Lithuania Has Chosen the French Model', *Lietuvos Rytas* (22 January 1993), at p 8.

121 Financial Instruments Markets Act, art 44(1).

122 Public Trading in Securities Act, art 20.4.

123 Public Trading in Securities Act, art 21.1.

124 A major holding in a stock exchange is subject to the same conditions as financial brokerage enterprises; Securities Market Act, art 42; The right to perform the activities of a market operator in the Republic of Lithuania shall be granted only the public limited liability companies whose trading systems hold a licence as a regulated market issued by the supervisory institution; Financial Instruments Markets Act, art 44(1).

125 Financial Instruments Markets Act, art 47.

Although a stock exchange is organised as an enterprise, it is an important securities regulator. The stock exchange adopts trading rules, which are subject to the approval by the Bank of Lithuania. It may establish conditions for listing of securities and suspend trades in some securities, according to the securities trade rules. The stock exchange may request disclosure by its members on their financial and commercial activities, and it has the power to examine compliance by its members of the exchange regulations and apply sanctions for violations of such rules.

Nature of Lithuanian Securities Market

The need to discuss the dematerialised nature of securities arises because this has specific implications for Lithuanian securities law. Dematerialised securities trading is an essential feature of the Lithuanian securities market. Indeed, all trades on the National Stock Exchange of Lithuania are completely dematerialised. Material instruments cannot be listed there. However, this concept goes far beyond the mere technicalities of transacting and the rooms of the stock exchange. It has wider legal implications relating, for instance, to the transferability of the instruments, and private law matters, and it may even affect the regulatory regime.

The idea of dematerialisation can be traced to the times of initial privatisation of state property when nationals of Lithuania were granted investment vouchers to be used in the process of privatisation. The vouchers were never printed and only existed in book-entry form. This concept was implemented in the context of the emerging securities market in May 1993 by way of amendments to Resolution Number 815.[126]

According to the amendments, all publicly issued securities had to be accounted in special securities accounts to be managed by the issuers or intermediaries.[127] It was thought that dematerialised trading was more efficient, inevitably resulting in the decrease of transaction costs (no printing, storage, or transportation costs), and helped to ensure a higher level of safety (eg, against risks of forgery, loss, and theft) and prompt and less cumbersome execution of transactions.[128]

Thus, in the context of stock exchange trading, Lithuania is not far behind the countries of Western Europe, which introduced the dematerialised trading system in the late 1980s and early 1990s.[129]

The law had to cope with the emerging concept. The second Companies Act of 1994, for the first time in legislation, explicitly recognised the possibility for

126 Resolution Number 352 of 20 May 1993, amending Resolution Number 815, *Zin* (1993), no 17-444.

127 Resolution Number 352 of 20 May 1993, amending Resolution Number 815, *Zin* (1993), no 17-444, art 124.

128 Central Depository of Lithuania (August 1993 to January 1996), at pp 18 and 19.

129 Steil, 'The European Equity Markets. The State of the Union and an Agenda for the Millennium', *European Capital Markets Institute* (1996), at pp 4 *et seq*.

companies to choose the form of securities. Where the dematerialised form is chosen, securities must be evidenced by records in the securities accounts.[130] The Public Trading in Securities Act, as amended by the Securities Market Act, laid down more detailed rules on the accounting and the securities and operation of their accounts.

Prior to the coming into effect of the New Civil Code, private law was silent on the legal aspects of dematerialised securities. The New Civil Code expressly recognises and includes dematerialised securities into the regulatory regime of private law and applies the general rules on safekeeping to the safekeeping and administration of dematerialised securities.[131]

As a result of such legislative and regulatory initiatives, the system of dematerialised securities, existing only in book-entry form, has been created. It consists of two levels of accounts and their operation, namely:

- The lower (intermediaries or specific) level, where intermediaries accounts of particular securities are owned by particular investors; and
- The higher (Central Depository, or general) level, where general securities accounts of account operators with the Central Depository of Lithuania represent aggregate amounts of securities accounted by particular account operators (omnibus accounts).[132]

Securities, as such, are recorded by way of the entry in the securities account of an investor (so-called 'personal securities account') maintained at the lower level. Typically, personal securities accounts are opened in the name of an owner of such securities.[133] The Companies Act of 2000 even laid down a presumption that an owner of dematerialised shares is a person in whose name a securities account is opened.[134] Such presumption was fully in line with the concept enshrined in the Public Trading in Securities Act prior to its amendments of 25 September 2001.[135] However, amendments to the Public Trading in Securities Act of 25 September 2001, as well as the Securities Market Act, have introduced certain exceptions to this rule.

Amendments to the Public Trading in Securities Act of 25 September 2001, as a practical matter, removed formal obstacles to the possessory pledge of securities by stipulating that personal securities accounts may be opened in the name of a pledgee of securities. In this case an owner of pledged securities is also recorded in the securities account. Recording in the securities account opened in the name of a pledgee is automatically deemed as the delivery of possession but not the title (ownership) to the pledgee.[136]

130 Companies Act, arts 32.1 (shares) and 38.1 (bonds).
131 Civil Code, art 1.101.10
132 2012 Accounting Rules.
133 Markets in Financial Instruments Act, art 64.1.
134 Companies Act, art 43.2.
135 *Zin* (2001), no 85-2971.
136 Financial Instruments Markets Act, art 64.2.

Furthermore, the Securities Market Act provided that client accounts of account operators registered in foreign countries may be opened in the name of such account operators by indicating that they act as account operators (omnibus accounts).[137] A Lithuanian account operator is obliged to ensure that, in case an omnibus account is opened in the name of a foreign account operator, the latter's clients can be identified upon request of the supervisory authority (the Bank of Lithuania) or the Central Depository.

The Companies Act grants an opportunity for private limited companies to manage securities accounts by themselves.[138] Prior to the amendments to the Public Trading in Securities Act of 13 July 2000,[139] public limited companies which were not licensed as securities brokers could trade in securities issued by them. However, the amended Public Trading in Securities Act revoked such rights of issuers.[140]

This rule was changed again in 2007 by the Financial Instruments Markets Act and the Securities Act; these provide that only securities of public limited companies being market participants, ie, issuers in the sense of the Securities Act, must be recorded by securities brokers.

In practice, the situation remains the same, ie, no one has asked to revoke earlier securities accountancies operated by intermediaries and most likely neither the the Bank of Lithuania nor market participants will initiate such change, except for some individual case-by-case applications.

Unless the investor has ordered otherwise in writing, an intermediary authorised by the issuer serves as the account operator for securities of such an investor.[141] An account operator maintaining a personal securities account is obliged, at the request of the shareholder, to issue a statement of the securities account.[142] Such a statement is not the security, and is not transferable. The account statement, for example, is necessary for the purposes of the participation and voting at the shareholders' meetings in case of bearer securities.[143]

The issuer, too, has the right to require, at any time, an intermediary to provide the lists of the owners of its securities by way of request addressed to the Central Depository.[144] The Companies Act since 2003 grants such a right to issuers with regard to registered shares only,[145] not with regard to bearer instruments.

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137 Markets in Financial Instruments Act, art 64.3.
138 Companies Act, art 41.3.
139 *Zin* (2000), no 61-1837.
140 The same concept is maintained in the Securities Market Act and the Companies Act of 2000.
141 Markets in Financial Instruments Act, art 65.3.
142 Companies Act, art 41.4.
143 Companies Act, art 21.
144 Markets in Financial Instruments Act, art 65.4.
145 Companies Act, art 41.5.

Significantly, it is assumed that the title to securities never passes to the account operators. They are not allowed to pool similar securities owned by different clients and/or by themselves. Securities must be segregated (each account identified), not only by the owner, but also by the particular issue of securities. For each investor, separate accounts must be opened with regard to different issuers and issues. Each issue must be accounted in a separate book. The securities of each client and of the intermediary must be recorded in a separate division of the book.

At the higher level, there are the accounts of account operators with the Central Depository (so-called 'general securities accounts'). To ensure efficient functioning of the system and regulatory surveillance of the accounting of securities, every account operator, before starting the operation of personal securities accounts, must have become a member of the Central Depository of Lithuania.[146]

The general account represents the aggregate number of securities accounted by a particular account operator (for the benefit of investors). By means of this arrangement, the Central Depository of Lithuania is able to control the correspondence of the total amount of dematerialised securities in circulation with that of the issued and registered ones.

Any transfer of dematerialised securities is performed by means of crediting and debiting the relevant securities accounts. Where the transfer is between investors who keep their securities accounts with different account operators, it must necessarily be cleared through the Central Depository since this involves debit entry on the transferor's account, the operator's general account with the Central Depository, and corresponding credit entry on the transferee's side.

Each account operator, in turn, makes appropriate entries in his clients' accounts (credit on the transferee's account and debit on the transferor's one). Where the transfer is between clients of the same account operator, in principle, it is possible to avoid clearance through the Central Depository because, in this case, the change in the general account of the account operator is not involved. However, in the latter case, market concentration and transparency considerations are relevant. Brokers may, nonetheless, be required to register the transaction with the Stock Exchange and report its volume and prices.

The concept of dematerialisation has been introduced by means of administrative measures not preceded or followed by public legal discussion of its implications. No concerns have been expressed in relation to private law. The Civil Code effective at that time, with its traditional concepts of property and obligations, remained untouched. Because Lithuania has skipped over the phase of physical securities' market, the legal concepts and rules applicable to material securities trading, which could be used as a basis for construction of new concepts by analogy, have not been developed. Thus, prior to the coming into

146 2012 Accounting Rules.

effect of the New Civil Code, there was a legal vacuum in private law relating to securities regulation.

The New Civil Code, however, already deals with dematerialised securities. For instance, it expressly prescribes the application of general rules on safekeeping to account operators of dematerialised securities,[147] and provides exemptions from the general regulation of sale and purchase agreements to stock exchange transactions,[148] securities sale and purchase,[149] and repurchase agreements.[150]

The Lithuanian system virtually abolishes the idea of a bearer security, despite attempts of the Companies Act 2000 to remove the inconsistencies with its underlying concept. Pursuant to the relevant Securities Commission rules, the identity of the holder of the security must always be known to the account operator and the Central Depository, regardless of whether the security is the registered or the bearer instrument.[151] This information may presumably be subject to the state authorities, such as the Tax Inspectorate. In addition, the Companies Act 2003 provides that all shares must be registered.[152]

Legal Order and Regulatory Interests

Admission

Market Participants

Intermediaries. The term 'intermediary' is defined in the Markets in Financial Instruments Act by way of enumerating institutions which are considered as intermediaries. In practice, this includes two kinds of entities, namely:

- Brokerage firms; and
- Authorised commercial banks.

A commercial bank is defined by the Law on Banks and is vested with the status of an intermediary by virtue of law (unless its banking licence is restricted). A brokerage enterprise is defined by the Financial Instruments Markets Act as a legal person whose regular business is the provision of one or more investment services to third parties and/or the performance of one or more types of investment activities on a professional basis. It may be possible that financial brokerage firms established in other member states do not have the status of a legal person.[153]

147 Civil Code, art 1.101.10.
148 Civil Code, art 6.430.2.
149 Civil Code, art 6.305.2.
150 Civil Code, art 6.418.6.
151 Rules on Identification of Clients of Intermediaries of Public Trading in Securities, approved by Resolution of Securities Commission on 23 June 2005, *Zin* (2005), no 80-2937, as amended.
152 Companies Act, art 40.2.
153 Financial Instruments Markets Act, art 3.7.

Only financial brokerage firms holding the licence of a financial brokerage firm issued by the Bank of Lithuania or the supervisory institution of another member state and credit institutions licensed in Lithuania or another member state where the licence of a credit institution grants the right to provide investment services, and the financial adviser undertakings holding the licence of a financial adviser undertaking as issued by the Bank of Lithuania, may provide investment services in Lithuania as a regular occupation or business on a professional basis.[154] This provision will not apply to a market operator operating a multilateral trading facility and not proposing to provide other investment services.[155]

Previously, commercial banks were allowed to engage in the securities business but, in principle, they were subject to double authorisation. The general banking licence was issued by the Bank of Lithuania. Normally, it included the authorisation to engage in the securities business. However, such authorisation was subject to the consent of the Securities Commission. Having regard to the fact that the Bank of Lithuania overtook the functions of the Securities Commission, the double authorisation procedure was simplified and commercial banks are now allowed to engage in the securities business upon obtaining a consent of the Bank of Lithuania at the time of issuance of the general banking license.

In line with the Investment Services Directive,[156] intermediaries are, pursuant to the Financial Instruments Markets Act,[157] authorised to render the following investment and non-core services:

- Reception and transmission of orders;
- Execution of orders on behalf of clients;
- Dealing on own account;
- Management of a financial instrument portfolio;
- Provision of investment advice;
- Underwriting and/or placing of financial instruments on a firm commitment basis;
- Placing of financial instruments without a firm commitment basis; and
- Operation of a multilateral trading facility.

Brokerage enterprises are not allowed to engage in other business activities. Brokerage firms are subject to initial capital requirements under the threat of refusal or withdrawal of authorisation.[158] Apparently, following the example of

154 Financial Instruments Markets Act, art 4.1.
155 Financial Instruments Markets Act, art 4.3.
156 Directive 93/22/EEC, Annex, Sections A and C.
157 Financial Instruments Markets Act, art 3.13.
158 Financial Instruments Markets Act, art 6. Rules on Issuing of Licences to Financial Brokerage Enterprises, approved by the Resolution of the Board of the Bank of

the EU Capital Adequacy Directive,[159] the Securities Commission has classified all brokerage firms into three groups — A, B, and C.[160]

Group A comprises brokerage firms intending to conduct all activities set out in the Financial Instruments Markets Act.[161] Group B consists of firms that do not engage in the trade in securities for their own account, or underwriting of securities issues on a firm commitment basis and managing multipurpose trade systems.[162] Group C consists of firms that render only the following investment services:[163]

- Reception and transmission, on behalf of investors, of orders in relation to securities;
- Placing of securities issues without an underwriting obligation;
- Investment advice concerning securities; and
- Managing securities portfolios in accordance with mandates given by clients, provided that execution of orders to buy and to sell securities and safekeeping and administration of securities is transferred to another brokerage firm of level B or A.

The Bank of Lithuania has established requirements on the minimum capital of the firms of each group in line with the amounts enshrined in the Capital Adequacy Directive. In particular, the own capital of Group A firms must be at the minimum level of EUR 730,000. The level required for Group B firms is EUR 125,000. The level for Group C firms is EUR 50,000.[164]

In addition, brokerage firms are subject to capital adequacy requirements, position risk, counterparty and settlement risk, and large exposure requirements.[165] For

Lithuania on 13 December 2012, in effect as from 22 December 2012, *Zin* (2012), no 151 -7755, art 19.

159 Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions, OJ L141, 11 June 1993, at p 1. Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings, and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC, and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

160 Regulation on Capital Adequacy Requirements for Licensed Financial Brokerage Firms and Management Enterprises, approved by Resolution of the Securities Commission on 22 March 2007, in effect as from 1 January 2008, *Zin* (2007), no 36-1349, which was put into new wording by Resolution of the Board of the Bank of Lithuania on 12 July 2012, in effect as from 25 July 2012, *Zin* (2012), no 88-4645.

161 Rules on Issuing of Licences to Financial Brokerage Enterprises, art 18.1.

162 Rules on Issuing of Licences to Financial Brokerage Enterprises, art 18.2.

163 Rules on Issuing of Licences to Financial Brokerage Enterprises, art 18.3.

164 Regulation on Capital Adequacy Requirements for Licensed Financial Brokerage Firms and Management Enterprises (arts 11, 12, and 15).

165 Regulation on Capital Adequacy Requirements for Licensed Financial Brokerage Firms and Management Enterprises (arts 56–58).

example, the capital adequacy of a financial brokerage firm is expressed by the ratio of liquid own capital and capital adequacy requirement. A firm is said to meet the capital adequacy requirement when this ratio is higher than one. Some of the other requirements apply to a firm depending on its category (ie, Group A, B, or C). For instance, position risk must be calculated only by Group A financial brokerage firms with respect to all their trading book items.

License for financial brokerage enterprises are issued by the Bank of Lithuania. To obtain a license for a financial brokerage firm, the following information must be submitted to the Bank of Lithuania:

- The operating plan;
- The documents of the firm (including most recent annual financial statements and auditor's report);
- Information about the owners;
- Information about the management members;
- A calculation of capital adequacy and documents certifying the formation of the share capital;
- Information on close links with other natural or legal persons;
- A complete description of the premises and the equipment used by the firm;
- Documents attesting to an obligation to become a member of a recognised investor insurance system;
- Information on the financial brokers employed or intended to be employed and other employees providing the investment services;
- Proof of payment of the state charge for the issuing of the licence;
- Documents and information related to the measures and the procedures meant to ensure compliance with the organisational requirements imposed on financial brokerage firms;
- The operations organisation policy;
- The business continuity (uninterrupted operations) policy;
- A description of the administration and accounting policy and procedures;
- The internal control regulations and information on a person in charge of the enforcement of the internal controls;
- Information on compliance policy and the person in charge of the enforcement of compliance policy;
- A description of the risk management policies, procedures, and measures;
- The policy on the avoidance of the conflicts of interests;
- The rules for the examination of customer complaints;
- A description of the measures designed for control of personal transactions, protection of client assets, and prevention of reduction and loss of client assets;
- The order execution policy;

- The procedure for the enforcement of anti-money laundering measures;
- Information on the readiness to submit the transaction information to the Securities Commission on the basis of the Transaction Reporting System (TRS); and
- Information on information technology systems employed.

A license can be withdrawn essentially when the above conditions for the obtaining of a license cease to exist or when the firm does not meet capital adequacy requirements, is unable to pay its debts, as well as in other cases equivalent to those listed in the Investment Services Directive.[166]

Only members of the Stock Exchange may trade on the Stock Exchange, ie, financial brokerage firms authorised by the Securities Commission (now by the Bank of Lithuania) to act as market intermediaries and banks, the licences of which do not preclude them from engaging in operations with securities. Such to-be members of the Stock Exchange must apply to the Board of the Stock Exchange for a permit to trade on the Stock Exchange.[167] Together with the application, they must submit certain documents and comply with the Board's requirements. When the Board of the Stock Exchange issues a permit to trade on the Stock Exchange, such participants of the Stock Exchange become Stock Exchange members.

Only those financial brokerage firms that hold a general Group A licence or a specialised Group B licence issued by the Securities Commission (now by the Bank of Lithuania) may trade on the National Stock Exchange. On applying for membership, the financial brokerage firm or a bank also is obliged to become a member of the Stock Exchange Guarantee Fund and:

- Pay the initial contribution of the amount set forth in the rules of formation and use of the Guarantee Fund;
- Pay the annual fee for the participation in the Stock Exchange trading;
- Become a direct member of the Central Depository and/or other clearing system approved by the Stock Exchange;
- Make an agreement with the Stock Exchange concerning settlement of transactions concluded on the Stock Exchange;
- Acquire technical means and software for the participation in the Stock Exchange trading that meet criteria approved by the Board of the Stock Exchange; and
- Employ at least two qualified brokers.

166 Directive 93/22/EEC, art 3.7, replaced by Directive 2004/39/EC.

167 AB NASDAQ OMX Vilnius participation (membership) and trading rules (Trading Rules), approved by the Management Board of the Stock Exchange, as amended from time to time.

The qualified brokers have to have at least six years prior experience in financial markets, proof that thye have acquainted themselves with the acts regulating the trading on the Stock Exchange, and proof of adequate economic, financial, and analytic skills. Each authorised broker has to pass a trading exam.

The right of a Stock Exchange member to trade on the Stock Exchange will be suspended or withdrawn by the decision of the Management Board of the Stock Exchange in certain cases, mainly those relating to the licensing and breaches of the regulatory regime.

Domestic Exchanges. As noted, the Vilnius Stock Exchange of Lithuania (AB NASDAQ OMX Vilnius) is the only securities exchange currently in existence in Lithuania. The Financial Instruments Markets Act, however, provides an opportunity for several securities exchanges to operate in Lithuania. Every exchange must be licensed by the Bank of Lithuania.

The Bank of Lithuania may refuse the licence if the incorporation documents of an exchange, the exchange trading rules, or other documents submitted to the Bank of Lithuania contravene Lithuanian laws, the information submitted is false, the economic substantiation of the exchange is insufficient for the exchange to properly operate, or the persons holding qualified holdings do not comply with the requirements of the Markets in Financial Instruments Act.

Off-Market Transactions and Transborder Electronic Trading Systems. Due mainly to the market concentration requirement, an effective over-the-counter trading system did not exist in Lithuania until the changes at the end of 2007. As mentioned earlier, the First North alternative market is the only alternative trading platform to the Vilnius Stock Exchange.

Similarly, there is no effective transborder electronic trading system, except the Lithuanian–Latvian–Estonian market, although larger banks and securities brokers in practice appear to conduct transactions on foreign markets for their own account through their own electronic connections.

Securities

Definition of Security. The definition of a security is important as it determines the scope of applicability of the Securities Act. An investor is defined in terms of the ownership of securities.[168] A person who has acquired instruments other than securities within the meaning of the Securities Act may not necessarily be considered as an investor and is not afforded relevant protection. The issue and the issuer are defined in the Securities Act with reference to the security and, consequently, such requirements imposed on the issuer as prior publication and registration of prospectus[169] and the periodic disclosure of information[170] are not

168 Under the Securities Act, art 2, para 18, an 'investor' is defined as 'a person who holds securities by the right of ownership, or intends to acquire securities'.

169 Securities Act, arts 5–6, 8.

applicable to the extent an instrument issued is not covered by the definition of a security.

Only instruments that are securities within the meaning of the Securities Act can be considered for the admission and listing at the Vilnius Stock Exchange. For example, only shares of issuers in the sense of the Securities Act can be admitted to the trade list.

Generally, in Lithuanian private law, the term 'security' has a very broad meaning. Consistently with the New Civil Code, it is somewhat vaguely understood as a document embodying the obligation of its issuer to the holder of such document (it can literally be translated as 'valuable paper').[171] Thus, negotiable instruments (such as bills of exchange and promissory notes), as well as documents of title, consignment notes, bills of lading and, possibly, certificates of deposit, may be considered as securities.[172] It can be seen that this concept comprises not only instruments used in an investment context, but also those used in daily commercial practice. Investor protection and the related regulatory regime are not always relevant to all of those instruments.

Consequently, the Civil Code provides that for the purposes of investor protection and capital market supervision, other laws may lay down a different definition of securities (investment), which definition is employed in the laws governing relevant relations.[173] Based on this, the Financial Instruments Markets Act fully includes into its regulatory sphere only such securities which may be traded on securities markets, namely:

- Shares in companies and other securities equivalent to shares in companies, the societies operating on the basis of partnership and other entities, and depositary receipts in respect of shares;
- Bonds and other forms of non-equity securities, including depositary receipts in respect of such non-equity securities; and

170 Securities Act, art 20 and Markets in Financial Instruments Act, art 3.14.

171 Civil Code, art 1.101.1.

172 Under the Civil Code, art 1.101, para 1, 'a security, as an object of civil rights, is a document certifying the obligation of its issuer to the holder of this document. A security can confirm the right of the person in possession of the document (holder) to receive from the issuer interest, dividends, part of an enterprise upon its liquidation, or the funds lent to the issuer (shares, bonds, etc.); the right or duty to acquire or alienate for payment or gratuitously other securities (subscription rights, futures contracts, options, convertible bonds, etc.); the right to some income or payment duty subsequent to a change of prices on the securities market (index, etc.). A security also is a document by which a direct order is issued to a bank to pay a certain sum of money (cheques) or which certifies a duty to pay a certain sum of money to the person whose name is indicated in such a document (promissory note, bill of exchange); or which proves the right of ownership to commodities (documents of title); likewise a document which certifies the right or duty to acquire or alienate documents of title (derivative documents of title)'.

173 Civil Code, art 1.101.2.

- Other securities giving the right to acquire or transfer transferable securities or giving rise to cash settlements determined by reference to transferable securities, currencies, interest rates, yields, commodities, or other indices or measures.[174]

Consistent with the dual concept of securities, as enshrined in the Investment Services Directive, the above instruments may be referred to as securities *stricto sensu*. Additionally, the Financial Instruments Markets Act applies, however, to a different extent, its regulatory regime to investment instruments and deems investment instruments as securities for regulatory purposes. Investment instruments are defined in the light of the Investment Services Directive[175] as the following securities or deeds:

- Transferable securities;
- Money-market instruments;
- Units in collective investment undertakings;
- Options, futures, swaps, forward rate agreements, and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices, or financial measures which may be settled physically or in cash;
- Options, futures, swaps, forward rate agreements, and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);
- Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF;
- Options, futures, swaps, forwards, and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in point 6, above, and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, *inter alia*, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;
- Derivative instruments for the transfer of credit risk;
- Financial contracts for differences; and
- Options, futures, swaps, forward rate agreements, and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative

174 Financial Instruments Markets Act, art 3.27.

175 Directive 93/22/EEC, Annex, Section B, repealed by Directive 2004/39/EC, Annex I, Section C.

> contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, *inter alia*, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses, or are subject to regular margin calls.[176]

Thus, for instance, prior authorisation requirements, supervision of the Bank of Lithuania, as well as other regulatory measures set out in the Financial Instruments Markets Act, are applicable to intermediaries dealing with both securities *stricto sensu* and investment instruments. Furthermore, contracts relating to both securities *stricto sensu* and investment instruments are subject to certain requirements set out in the Financial Instruments Markets Act, and investment instruments like securities *stricto sensu* may be listed and traded on stock exchanges. Finally, rules applicable to stock exchanges, the Bank of Lithuania, and liability for contraventions apply in connection with both securities and investment instruments. However, issue registration requirements, rules relating to primary and secondary offerings, prospectuses, and disclosure and reporting requirements, rules on acquisition of qualifying holdings and tender offers, as well as rules on accounting of securities apply only to securities *stricto sensu.*[177]

In general, the form of the instrument (ie, physical or dematerialised, whether it is represented by the document or not) is irrelevant for the definition in the Financial Instruments Markets Act. This is evidently to reflect the system of dematerialised securities which has emerged in Lithuania.

In contrast with the Public Trading in Securities Act, the Securities Market Act has significantly approximated the concept of securities with EU legal requirements. This is also reflected in the Financial Instruments Markets Act.

Notes and bills issued pursuant to the Law on Bills of Exchange and Promissory Notes,[178] as well as cheques and 'payment instruments' defined in the Payment Act',[179] are exempted from the regulatory regime of the Financial Instruments Markets Act.[180] The Payment Act defines 'payment instruments' as any personalised device and/or set of procedures agreed between the payment service user and the payment service provider and used by the payment service user in order to initiate a payment order.[181]

The Civil Code further expressly includes electronic payment instruments into the notion of 'payment instruments'.[182] However, the use of the term 'payment

176 Financial Instruments Markets Act, 3.4.
177 Securities Act, art 3.1.
178 Law on Bills and Promissory Notes of 16 March 1999, *Zin* (1999), no 30-851, as amended.
179 Payment Act of 28 October 1999, *Zin* (1999), no 97-2775, as amended, art 2.21.
180 Financial Instruments Markets Act, art 3.27–3.28.
181 Payment Act, art 2.21.
182 Civil Code, art 6.915.

instruments' to refer to the above instruments is debatable. Conceptually, only money, questionably also electronic money, should be regarded as a payment instrument, whereas the above instruments should be deemed as means of payment. This distinction is clearly reflected in the Commentary to the Civil Code.[183]

Securities and Issuer Requirements for Listing. Currently, there are four lists of securities at the Vilnius Stock Exchange, these being:

- The Official List;
- The Secondary List;
- The List of Debt Securities; and
- The List of Investment Units (Funds).

Under the Companies Act, there are two types of companies, ie, public companies and private (or closed) companies. The minimum share capital of a public company must be at least LTL 150,000 and that of a private company LTL 10,000. If the number of shareholders exceeds 249, the company must be registered as a public company. Private companies may not publicly issue the shares (their shares may not be traded on the public market), and are prohibited from issuing publicly traded bonds.[184] At the same time, public limited companies cannot place their securities for the trade if the issuer does not fit to the issuer category under the strict meaning of the Securities Act. Under the Partnerships Act, partnerships are not allowed to issue securities.[185] Accordingly, as a practical matter, public companies are the only Lithuanian entities that may effectively issue securities and are 'admitted' to the Bank of Lithuania list of issuers.

According to the Trading Rules of the Vilnius Stock Exchange, shares of the issuer may be admitted to the Official List of the Stock Exchange by the decision of the Board of the Stock Exchange, subject to the conditions listed in the Trading Rules of the Vilnius Stock Exchange. Said conditions have been basically laid down in line with the provisions of Directive 2001/34/EC (which was amended by Directives 2003/71/EC, 2004/109/EC, and 2005/1/EC),[186] and include the following requirements:

- The legal position of the issuer is in conformity with the laws and regulations to which it is subject, as regards its formation and its operation;

183 C*ommentary to the Civil Code of the Republic of Lithuania* (2003), Book VI, vol I, at p 65.

184 Companies Act, art 55.11.

185 Partnership Act of 16 October 1990, *Zin* (1990), no 31-747, as amended, art 6.3.

186 Directive of the European Parliament and of the Council of 28 May 2001 on the admission of securities to the official stock exchange listing and on information to be published on those securities (2001/34/EC), OJ 2001 L 184/1, as amended.

- The issuer has prepared and published a securities prospectus in accordance with the requirements set forth in the Trading Rules of the Vilnius Stock Exchange or has published a prospectus meeting the requirements applicable to a prospectus for admission to the Official List (exception is made to securities issued by collective investment undertakings);
- The issuer has conducted business continuously for at least three years (the Board of the Stock Exchange may make exceptions to this requirement);
- The legal position of the shares is in conformity with the laws and regulations to which they are subject;
- The shares are freely negotiable, fully paid up, and granting the same rights to their owners (the Board of the Stock Exchange is authorised to make exceptions to the requirement for the shares to be fully paid up, as well as in case of shares which may be acquired only subject to approval);
- The foreseeable market capitalisation of the shares for which admission to Official Listing is sought or, if this cannot be assessed, the company's capital and reserves, including profit or loss, from the last financial year, must be at least EUR 4 million (Trading Rules leave possibility for leeway if there is sufficient interest in trading such securities on the regulated market). For admission to the Secondary List, the capitalisation requirement is EUR 1 million as defined in Directive 2001/34/EC.
- A sufficient number of shares has been distributed to the public in Lithuania or in one or more EU member states prior to the admission (a sufficient number of shares and exception to this requirement are determined in accordance with the requirements of Directive 2001/34/EC);
- Accounting of securities is conducted in accordance with the requirements of Lithuanian laws and regulations applicable to account operators;
- Where public issue precedes admission to the Official List, the shares may be listed only after the registration of the increase of the authorised capital in accordance with the procedure prescribed by the law;
- The application for admission to the Official List must cover all the shares of the same class already issued (the Board of the Stock Exchange may make exceptions to this requirement in line with the requirements of Directive 2001/34/EC);
- If the shares issued by a company which is a national of a non-EU member country are not listed in either the country of origin or in the country in which the major proportion of the shares is held, they may not be admitted to the Official List, unless the Board of the Stock Exchange is satisfied that the absence of a listing in the country of origin or in the country in which the major proportion is held is not due to the need to protect investors.

Depositary receipts may be admitted to the Official List, provided that:

- The issuer of shares meets the first three requirements applicable to the issuers the admission of whose shares to the Official List is being sought (ie,

conditions relating to the legal position of the issuer, market capitalisation, and annual accounts), and has complied with the obligations applicable to the companies whose shares are admitted to the Official List;

- The issuer of depositary receipts has prepared and published an information bulletin in accordance with the requirements prescribed by the Trading Rules of the National Stock Exchange; and
- Depositary receipts meet the conditions relating to the shares of which admission to the Official List is being sought (distribution of sufficient number of shares, freely negotiable shares, and others).

Pursuant to the Trading Rules of the Vilnius Stock Exchange, government securities, as well as debt securities with a maturity longer than one year issued by the governmental, regional, or local authorities of other countries as well as international organisations, may be admitted to the Official List. All such debt securities have to be freely transferable and negotiable.

Other debt securities may be admitted to the Official List subject to the conditions laid down in the Trading Rules of the Vilnius Stock Exchange. Notably, the Trading Rules provide for a more extensive list of requirements applicable to other debt securities than Directive 2001/34/EC and Directive 2003/71/EB, and include basically the same conditions as those applicable to the admission of shares, ie:

- The legal position of the issuer is in conformity with the laws and regulations to which it is subject, as regards its formation and its operation;
- The issuer has published or filed its annual accounts prepared in accordance with Lithuanian legislative requirements or international accounting standards and audited in accordance with international accounting standards for two financial years preceding the application for official listing (exception to the requirement of three years may be applied by the Board of the Stock Exchange also not applicable to securities issued by the governmental, regional, or local authorities of other countries, as well as international organisations);
- The issuer has prepared and published an information bulletin in accordance with the requirements set forth in the Trading Rules of the National Stock Exchange or has published a prospectus meeting the requirements applicable to a prospectus for admission to the Official List;
- The issuer was operating profitably in the course of the last financial year (the Board of the Stock Exchange may apply exceptions to this requirement);
- The legal position of the debt securities is in conformity with the laws and regulations to which they are subject;
- The debt securities are freely negotiable, fully paid up, and granting the same rights to their owners (the Board of the Stock Exchange is authorised to make exceptions to the requirement for the debt securities to be fully paid up);

- The debt securities in respect of which application for admission has been made are in the hands of the public to the extent of at least 25 per cent of their issue or when, in view of the large number of such debt securities and the extent of their distribution to the public, the market will operate properly with a lower percentage;
- The nominal value of the debt securities issue is no less than EUR 200,000, and the maturity of the debt securities is no longer than one year (the minimum nominal value requirement is not applicable in case of tap issues where the nominal value of the debt securities issue is not fixed, and not applicable to securities issued by the governmental, regional, or local authorities of other countries, as well as international organisations);
- Convertible or exchangeable debentures and debentures with warrants may be admitted to the Official List only if the related shares are already admitted to the Official List or listed on another regulated, regularly operating, and recognised in an EU member state open market or are so admitted simultaneously (exception is provided where the Board of the Stock Exchange is satisfied that holders have at their disposal all the information necessary to form an opinion concerning the value of the shares to which these debt securities relate). This requirement is not applicable to securities issued by the governmental, regional, or local authorities of other countries, as well as international organisations;
- Accounting of securities is conducted in accordance with the requirements of Lithuanian laws and regulations applicable to account operators; and
- The application for admission must cover all debt securities.

Notably, conditions relating to the admission to the Official List of securities issued by undertakings of EU member states are applicable only following Lithuania joining the EU in 2004.

The securities of the issuer may be admitted to the Secondary List of the Stock Exchange on the decision of the Board of the Stock Exchange where the issuer and securities correspond to the Trade Rules.

As can be seen, there may not always be a direct condition precedent to having a securities issue registered by the Securities Commission (now the Bank of Lithuania). This is because such a requirement is set *vis-à-vis* the Central Depository. To open the securities issue account with the Central Depository of Lithuania, a copy of the registered prospectus (prospectus) and documents evidencing such registration with the Securities Commission (now the Bank of Lithuania) must be submitted to the Central Depository of Lithuania.[187]

In other words, if the securities issue has not been registered with the Securities Commission (now the Bank of Lithuania), there is no legal possibility for the

187 2012 Accounting Rules.

securities issue to exist publicly, save for the exceptions prescribed by the Market in Financial Instruments Act, as well as by the Securities Commission or the Bank of Lithuania which, as mentioned, overtook the functions of the Securities Commission.

Trading Rules

Prospectus Requirements. Where the securities of the issuer whose home member state is Lithuania are intended to be offered publicly or admitted to trading on a regulated market in Lithuania and/or other member state, such issuer has to follow the requirements for admission of securities to trading on a regulated market and prepare and publish a prospectus. Where the home member state of an issuer is other than Lithuania, the requirements have to be complied with where the securities are intended to be offered publicly or admitted to trading on a regulated market of Lithuania. An issuer is also a legal person established in Lithuania, proposing to issue or issuing its securities. Requirements for admission of securities to trading on a regulated market are not applicable to:

- Securities issued (to be issued) by open-ended collective investment undertakings;
- Non-equity securities issued (to be issued) by a member state, its regional or local authorities, the European Central Bank, central banks of member states of the EU, and public international organizations of which at least one EU member state is a member;
- Shares of the central banks of member states;
- Securities unconditionally and irrevocably guaranteed by a member state, or its regional or local authorities;
- Non-equity securities issued in a continuous or repeated manner by credit institutions of member states, provided that such securities are not subordinated, convertible, or exchangeable, do not give a right to subscribe to or acquire other types of securities, or are not linked to a financial derivative, and provided the securities materialise reception of repayable deposits, and are covered by a deposit insurance coverage;
- Publicly offered securities issued by an issuer incorporated in a member state, provided the total consideration for the offer in the member states is less than €5 million calculated over a period of 12 months;
- Non-equity securities issued in a continuous and repeated manner by credit institutions incorporated in a member state where the total consideration for the offer in the member states is less than €75 million calculated over a period of 12 months, provided that such securities are not subordinated, converted, or exchangeable, do not give a right to subscribe to or acquire other types of securities and that they are not linked to a financial derivative.

The home member state should be interpreted as:

- For all Community issuers of securities — the member state where the issuer has its registered office;
- For all non-Community issuers of securities — the member state in which the securities were publicly offered for the first time after 31 December 2003, or intended to be offered, or where the first application for admission to trading on a regulated market is made. The home member state shall be designated at the discretion of the issuer, a person offering the securities, or a person asking for admission to trading on a regulated market, subject to a subsequent election by issuers incorporated in a third country if the home member state was not determined by their choice;
- For any issues of non-equity securities the denomination per unit of which amounts to at least €1,000, or for any issues of non-equity securities giving the right to acquire any transferable securities or to receive a cash amount as a consequence of them being converted or the rights conferred by them being exercised, provided that the issuer of non-equity securities is not the issuer of the underlying securities and is not related to the issuer of the underlying securities—the member state in which the issuer has the registered office or where the securities were or are to be admitted to trading on a regulated market, or where the securities are offered to the public. The same regime shall be applicable to non-equity securities in a currency other than euros, provided that the minimum denomination of such security is not less than €1,000.

Concept of Public Trading in Securities. Under the Securities Act, Article 2.58, public offering is defined as a communication to persons in any form and by any means offering securities and presenting sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe to the securities being offered. Offering of securities through intermediaries of public trading in securities shall also be deemed to be the public offering provided it meets the features of the public offering described previously. Communication to persons on the basis of trading in the regulated market of Lithuania is not deemed to be the public offering of securities. Admission of securities to trading in the multilateral trading facility, as well as the communication to persons on the basis of trading in the multilateral trading facility, is not deemed to be the public offering of securities.

The Registration Rules,[188] which were in force prior to the Securities Market Act, treated the following acts as the advertising for offering of securities and addressing the public:

188 Rules on Registration of Securities, approved by the Resolution of the Securities Commission on 30 May 2002, *Zin* (2002), no 63-2567, now Rules on Securities Prospectus and Information Disclosure, approved by the Resolution of the Board of

- An advertisement in media (such as newspapers, magazines, radio, and television);
- Information on offering of securities with the indication of the price of the issue in a publication or an interview to a media; and
- Printed, sound, visual, or other public advertisements and those transmitted via the telecommunications network.

Under current conditions, marketing of transactions that is related to official public offering or admission to the regulated market is mainly governed by the Law on Securities, Advertising Law.[189] There are no restrictions *per se* in carrying out marketing activities whether through media, telecommunications network, or other advertising means; however, any marketing campaign has to conform to the requirements below:

- Marketing must be clearly identifiable according to its form of presentation; surreptitious marketing is prohibited. Advertisements have to state that a prospectus has been or will be published and indicate where investors are or will be able to obtain it;
- Marketing of securities cannot include misleading information or such information that would deviate from the information provided in the published or to be published term-sheet or its annexes regardless of the fact of whether or not such information was disclosed for advertising purposes; information has to be accurate, fairly representing the risk factors, comprehensive, represented in a proper manner, and so on;
- Marketing of securities has to include all relative and important information about the issuer and the financial institution providing the investment services (if it is not the issuer); and
- Marketing documentation for professional investors has to state that it is intended to attract professional investors or a special category of investors and include information in the manner defined by the supervisory institution.

As regards marketing with respect to telephone calls, faxes, emails, or similar forms of communication, the Advertising Law sets forth that such direct marketing can only be carried out upon obtaining the consent of the receiver of the information.

Securities intended to be issued for non-public trading of securities, ie, in the absence of indications of public trading of securities, must be registered by the issuer at its own discretion for the public trading or private placement.

Exemptions from Preparation of Prospectus. The Securities Act provides exemptions to the securities issue for the preparation of the securities prospectus

the Bank of Lithuania on 28 February 2013, in effect as from 9 March 2013, *Zin* (2013), no 25-1251 (hereinafter — "Registration Rules").

189 Number VIII-1871, 18 July 2000, as amended.

taking into account the type of securities, their trading peculiarities, as well as the need for disclosure of information.[190]

Consequences for Violation of Registration Requirement. The legal consequences for the non-compliance with the prospectus registration requirement vary. Dematerialised, non-registered securities (which are subject to the registration of the supervisory authority) will not be admitted to the clearing system of the Central Depository; thus, trades in such securities on the Stock Exchange would be impossible. They would not be admitted to the Stock Exchange listing.

Under the Companies Act, shares of a public limited company issued into circulation without prior registration of the issue with the supervisory authority are void. An issuer is entitled to rely on the invalidity of the shares to the same extent as an investor. In the case of public primary offering, it is forbidden to advertise securities or announce their subscription until the prospectus is published. The Securities Act also authorises the supervising authority to penalise issuers, intermediaries, or other persons who organise or perform public trading of unregistered securities or of securities the registration of which has been suspended or cancelled.[191]

Thus, the liability under the Securities Act for the breach of the duty of registration is primarily administrative. The Securities Act does not introduce any new rules of civil liability that would otherwise be available under the general grounds of civil law, but provides that persons who have infringed the provisions of the Securities Act will be liable in the manner set by law. According to the general principles of the securities markets, this requires that investors be indemnified for loss.

Criminal liability is vague. The new Criminal Code[192] provides for criminal liability only for insider dealing and market manipulation.[193] Criminal liability for fraud is available on general grounds.[194]

Accuracy of Prospectus. According to the law and the Registration Rules, the prospectus is a document prepared for investors and the public that discloses the main facts relating to the issuer and the securities offered for public trading.

The registration of a securities issue with the supervisory authority is confirmation that the information provided by the issuer complies with the disclosure requirements of the Securities Act and the Registration Rules. The

190 Securities Act, arts 2.47 and 5; Listing Particulars Directive, arts 5 and 13.
191 Securities Act, art 47.
192 Criminal Code of 26 September 2000, *Zin* (2000), no 89-2741, effective 1 May 2003, as amended.
193 Criminal Code, arts 217 and 218.
194 Criminal Code, art 205.

Securities Act specifically establishes liability for the accuracy of the prospectus.[195]

In addition to the usual damages provision, the supervisory authority has the right to terminate the registration of the securities, in which case further sale of securities is forbidden. In both cases, it is primarily the issuer who is liable for the accuracy of the prospectus. The personal civil and criminal liability of the directors or other persons signing the prospectus is not clear.[196] Most probably, liability can only be established in case of fraud; mere negligence should not suffice.

Refusal of Registration. Under the Securities Act, the supervisory authority may refuse to register the securities issue if the information delivered does not comply with the rules determined by the supervisory authority, or the issuer has refused to deliver required documents, information, explanations, or corrections; or has delivered incorrect documents or statements; or securities are issued in violation of laws or securities regulations.

Primary Offerings. The Public Trading in Securities Act applied virtually the same requirements to primary offerings carried out through both public and private placement. The Securities Act, by contrast, has made a clear distinction between the rules governing public primary offerings and those governing private primary offerings.

Any primary trading in securities may be carried out by the issuer himself or through an intermediary.[197] Main rules that apply during all primary offerings are: equal conditions for acquisition of the offered securities must be insured to all potential investors; each potential investor must be afforded the opportunity to become acquainted with the prospectus and other registration documents;[198] procedure and terms of primary offering, as set out in the prospectus, may be changed only upon a permission of the supervisory authority; and the price, par value, class, or type of securities may not be changed.[199]

If, during the period of any primary offering, a material event has occurred or the information included in the prospectus has changed, an issuer must publish this pursuant to the procedure of publishing material events.

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195 Securities Act, art 7.

196 There is no precise provision in the criminal Laws of Lithuania that would make material misstatements or omissions in the prospectus a criminal offence; presumably, article 205 of the Criminal Code may be applied on general grounds; it imposes criminal liability on provision of misleading information on the 'activity or the assets of an enterprise in a report or application acting on behalf of an enterprise', provided that creditors, shareholders, the state or other institutions, or persons have been actually mislead with respect to such information and this has caused significant damage.

197 Securities Act, art 16.1.

198 Securities Act, art 16.2.

199 Securities Act, art 16.3.

Although the Companies Act of 2000 implied a possibility to carry out primary offerings through the Stock Exchange,[200] such possibility was diluted by the Public Trading in Securities Act and other securities legislation, in particular by the Registration Rules of 1998, which were in force when the Companies Act of 2000 came into effect.

The Securities Act has removed the obstacles for carrying out primary offerings through the Stock Exchange. The Act expressly provides that primary trading in securities may be effected through a stock exchange following the rules adopted by the supervisory authority, and allows the issuers to set minimum and maximum securities issue prices in the prospectus when offering securities through the stock exchange.[201] Nevertheless, the Bank of Lithuania (supervisory authority) has not yet adopted the rules implementing the provisions of the Securities Act in connection with the primary placements through the exchange.

Secondary Trade

Basic Rules and Market Concentration. Pursuant to the Securities Act, public secondary trading may only be executed through an intermediary. The Law also provides that 'the secondary trading in securities shall be conducted in accordance with the provisions of the Financial Instruments Markets Act of Lithuania'.[202] Moreover, any sale-purchase transactions in the secondary trading of securities may only be carried out on a stock exchange if securities are listed on the Official List or Secondary List of the exchange. A breach of these requirements may result in administrative liability up to LTL 100,000.[203]

Thus, Lithuania appears to have implemented the market concentration principle of the EU Investment Services Directive.[204] This has probably been influenced by French concepts as advice from French experts was important when drafting the Public Trading in Securities Act, in which this market concentration principle emerged.

Over-the-Counter Transactions. The Securities Market Act prohibited over-the-counter sale-purchase transactions in listed securities. Such prohibition is no longer existent in the Financial Instruments Markets Act. Securities Commission rules on reporting of over-the-counter transactions states that all such transactions have to be reported to the Central Depository.[205]

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200 Companies Act 2000, art 47.

201 Securities Market Act, arts 16.1 and 16.3.

202 Securities Market Act, art 17.

203 Securities Market Act, art 47.

204 Council Directive of 10 May 1993 on investment services in the securities field (OJ 1993, L141/27), art 14, as amended, Directive 2004/39/EC.

205 Rules on Submission of Notifications on Off-Exchange Transactions with Respect to Securities Listed on an Exchange, Resolution of the Securities Commission, approved by the Resolution of the Securities Commission on 4 May 2006, *Zin* (2006), no 55-1996, as amended.

Article 31.3 of the Law on Markets in Financial Instruments sets forth that upon entering into a transaction regarding the financial instruments admitted to trading on a regulated market, a financial brokerage firm must forthwith, no later than the end of the following working day, give to the supervisory institution a notice of the transaction entered into in accordance with the procedure laid down by the supervisory institution. This duty is applied whether or not the transaction has been entered into on a regulated market.

Bulk Transactions on Regulated Market. The idea of market concentration has existed in Lithuania from the beginning of the creation of market structures.[206] However, it was also understood that its absolute application would ignore real market circumstances and, at least in situations where counter-parties to the transaction have privately agreed the terms of transfer of the securities, it would be unreasonable to force them to go through the vehicle of a stock exchange trade, endangering the effectiveness of the agreement.

Parties to such a transaction (called a 'direct transaction') were allowed to use a simplified procedure of the registration of a transaction with the exchange without deviating from the principle that the transaction be executed on the exchange. This procedure also remained under the current acts.

Under the current rules, direct transaction may be effected on the Stock Exchange where intermediaries deliver matching sale and purchase orders on listed securities.

Direct transactions are registered by the Stock Exchange and are subject to transparency: the price, volume, and other terms of the transaction must be published. There may be no limitations imposed on the price of securities acquired in other sell or buy transactions. The transaction is deemed as carried out on the Stock Exchange, and it is subject to its other rules, as well. The direct-transaction procedure is important as, in many circumstances, it proves to be the only possibility to execute private secondary trading transactions.

Foreign Securities

With regard to prospectuses and their annexes, the allowed prospectuses are those prepared in accordance with the requirements of the Republic of Lithuania or the requirements of any other member state of the European Union and approved by the respective supervising authority of that member state. Article 13 of the Law on Securities requires that the prospectus approved by the member state supervising authority has to be submitted together with the translation of the summary of prospectus into Lithuanian language. The Law on Securities provides that the securities issued by a foreign issuer can only be subject to public offering or trade on the regulated market after the supervising authority of the issuer's member state transfers to the supervising authority of

206 The 'market concentration concept' was introduced by Resolution Number 815.

the Republic of Lithuania the copy of the prospectus and the affirmation that such prospectus has been prepared in accordance with the laws of that member state.

Where the supervisory institution determines that the issuer or the financial institutions responsible for the public offering of securities have violated the legal requirements of this Law and other legal acts applied to the issuers whose securities are publicly offered or admitted to trading on a regulated market, it immediately notifies of the established violations the home member state of the issuer as well as the European Securities and Markets Authority.

The Law on Securities provides that the supervisory institution publishes on its website the list of the prospectuses obtained in accordance with the above requirements and of the certificates of approval of all supplements thereto, as well as, where applicable, the internet reference to these documents published on the website of the competent authority of the home member state, the issuer or the regulated market. The published list of prospectuses and of the certificates of approval of supplements are constantly updated and each record is retained on the website for not less than a year.

Disclosure of Acquisition of Substantial Holdings

Under the Securities Act,[207] any person who, acting alone or in concert with others, acquires shares in a company amounting to 5, 10, 15, 20, 25, 30, 50, 75, and 95 per cent of the votes in such company must, within four days of crossing each such threshold (in either direction), inform the supervisory authority and the issuer of his shareholding of the amount of his votes. Both parties need to notify the supervisory authority and the issuer of the transaction (transferee, on acquisition; transferor, on disposal). The obligation is also binding upon the person directly or indirectly holding the securities that, subject to a formal agreement and upon an initiative of the holder thereof, entitles him to acquire in the future the securities issued by the issuer.

For the purposes of determining whether a person or a legal entity is required to make a declaration of acquisition or disposal of a major holding, regarded as voting rights held by that person or entity are those that:

- Are granted to a person by shares held thereby by the right of ownership (except where they are pledged as a security and the pledge agreement provides for the voting rights transfer to the security holder);
- Are held by another person with whom that person has concluded a voting agreement concerning the implementation of the corporate management policy;
- Are held by another person with whom he had concluded a provisional agreement on the transfer of the voting rights;

207 Securities Act, art 23.1.

- Are granted by shares that have been pledged or transferred as a financial security provided the security holder is authorised to use the voting rights attaching to the shares;
- Are granted by shares for which he as an usufruct authorised to use all his life or a determined period of time that may not be longer than the duration of the person's lifespan;
- Are according to the first five points, above, held by the entity controlled by the person;
- Are granted by the shares transferred to him by trust or otherwise deposited to him where the person, in the absence of other instructions, may exercise the voting rights at his own discretion;
- Are granted by shares acquired to his benefit but in the name of another person;
- May be used by the person at its own discretion under an authorisation or under other agency basis; and
- Are granted by the shares held by the spouse of the person except in cases when the nuptial agreements provide that securities are regarded as personal property of each of the spouses.[208]

The above amounts are calculated as regards all same-class shares that entitle voting rights, irrespective of whether the use of such shares has been suspended.

In line with Directive 2001/34/EC, the Securities Act lays down the following exemptions from the requirement to report the acquisition/disposal of the qualified holding:

- To members of the Central European Bank system performing monetary functions, also effecting pledge, repurchase, or other equivalent liquidity transactions within the payment system or for monetary policy purposes. This exclusion shall apply to short-term transactions provided the rights attaching to the shares are not exercised;
- A company belonging to a group of companies obliged to draw up annual consolidated financial statements, if a respective notification is submitted by its parent undertaking, or by the ultimate parent undertaking of the latter;
- A person who acquires the securities of the issuer only for the purposes of the mid-accounting or the settlement during the regular short-term settlement cycle. The maximum possible short-term accounting cycle shall be three trading days from the conclusion of a transaction.
- Account managers registered in member states and third countries who, acting as account managers, in the general meeting of shareholders have a

208 Securities Act, art 24.

right to vote in respect of the votes attached to shares only following the instructions of the customers submitted in writing or by electronic means.

- A market maker who in performing the activity of market maker is not involved in the management of the issuer in whose general meeting of shareholders he acquired or disposed of 5 per cent of votes or the votes above such threshold, and due to such acquisition or maintaining of the price does not affect the issuer.

The market maker shall within four trading days notify the competent authority of the use of such exemption. Notification procedure is prescribed by the Disclosure Rules.[209] Persons notifying the supervisory authority must also disclose to it holdings of securities that provide their right to vote and/or to hold the securities in the future (such as convertible bonds and convertible preference shares).

In the event of a person failing to notify the supervisory authority or the issuer of the acquisition in accordance with such a requirement, such a person, for the period until the proper disclosure of the data concerned, has the right to hold at the issuer's general meetings of shareholders more votes than the last threshold of which he has duly notified. Moreover, he is forbidden to have more votes in the general meeting of the issuer than the last threshold which has been reported.

In addition, all decisions adopted during the period between the acquisition of the holding and the moment of a proper disclosure of the information may be annulled by a decision of the court, if the decisions had resulted in a replacement of the issuer's managers or property or non-property rights of shareholders have been violated. Notably, the above sanctions are not applicable in the event of the failure to report the disposal of a qualified holding. Accordingly, the failure to report the disposal may result in an administrative penalty only. After the supervisory authority has received such information on the acquisition or disposal of major holdings, it must disclose it to the public.

Insider Dealing

Lithuania has implemented the new Insider Dealing and Market Manipulation Directive.[210] Notably, the definition of inside information as set out in line with Directive 89/592/EEC[211] has been changed.

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209 Rules on Disclosure of Information on Acquisition (Disposal) of a Block of Shares, approved by the Resolution of the Board of the Bank of Lithuania on 28 February 2013, *Zin* (2013), no 26-1269.

210 Directive of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (2003/6/EC), OJ 2003 L 096/16, amended by Directives 2008/26/EC and 2010/78/EU.

211 Directive 89/592/EEC, art 1.1.

Under the Financial Instruments Markets Act,[212] any persons who have access to inside information by virtue of being employees of the issuer's administration, by virtue of membership of the management or supervisory bodies, or by virtue of having access to such information through the exercise of their employment, profession, duties, or by virtue of being a shareholder of the issuer or by virtue of their criminal activities shall be prohibited from trying to enter or to enter for their own account or for the account of a third party, either directly or indirectly, into transactions in the financial instruments to which the information relates, until it is made public. Where the person referred to is a legal person, the appropriate prohibition also applies to the natural persons who take part in the decisions to enter into transactions for the account of the legal person concerned. The persons indicated above also are prohibited:

- From directly or indirectly forwarding inside information to another person, unless such disclosure is made in the normal course of the exercise of their employment, profession, or duties; and
- From recommending, inducing, or offering another person, on the basis of inside information, to enter into a transaction in the financial instruments to which the inside information relates.

The prohibitions specified also apply to any person who possesses inside information, while that person knows, or ought to have known, that it is inside information. However, the prohibitions do not apply to carrying out of the transactions entered into prior to familiarisation with the acquired inside information.

All prohibitions to take advantage of the inside information do not apply to transactions carried out in pursuit of monetary, exchange-rate, or public debt-management policies by the government, by the Central Bank, or any other body carrying out similar functions.

Under the Financial Instruments Markets Act, intermediaries are prohibited from rendering services in a transaction where they have information that such a transaction would violate the prohibition to take advantage of inside information and are obliged to report such information to the supervisory authority.[213]

Issuers are required to furnish certain information to the supervisory authority relating to persons having access to inside information and persons related to the issuer. Furthermore, to exercise at least a certain degree of control over insider transactions, the law requires directors of the issuer to report transactions in own-company securities. Such reports must be filed with the supervisory authority on a regular basis, at least once a month. Such information is made publicly available by the supervisory authority.

212 Financial Instruments Markets Act, art 62.
213 Financial Instruments Markets Act, art 62.

The Financial Instruments Markets Act also provides that an issuer or a person acting on behalf of or for the account of the issuer who discloses inside information to any third party in the normal exercise of his employment, profession, or duties must simultaneously (in the case of non-intentional disclosure — immediately after the disclosure) make effective public disclosure of the entire information. This requirement shall not apply if the person receiving the information owes a duty of confidentiality based on regulations, on articles of association of an undertaking, or on a contract. Issuers, or persons acting on behalf of the issuers or for their account, must, in accordance with the procedure laid down by the supervisory institution, transmit to it data (including personal numbers) of the persons having the right to be familiar a with inside information under contracts of employment or otherwise.

Prohibition of the use of inside information and prohibitions with regard to market manipulation (described below) in respect of the financial instruments which are traded on the regulated markets or multilateral trading facilities situated or operating in the Republic of Lithuania (or for which a request for admission to trading on such markets or facilities has been made) apply both to the actions carried out on the territory of the Republic of Lithuania and abroad.

The prohibitions and requirements in respect of the financial instruments which are traded on the regulated markets or multilateral trading facilities situated in any other member states (or for which a request for admission to trading to such markets or facilities has been made) apply to the actions carried out in the territory of the Republic of Lithuania, even if an appropriate transaction has been entered into outside such a market.

The Financial Instruments Markets Act provides that the entity that is in breach of prohibition against insider dealing and market manipulation is subject to administrative liability up to LTL 200,000. The Criminal Code expressly provides criminal liability for insider dealing:

> 'A person who, having knowledge of inside information about the issuer's material events or about any other information relating to the issuer or its securities, enters, directly or through brokers, into transactions in respect of the securities of that particular issuer or discloses such information to a third party, or recommends or offers for a third party to acquire or transfer the securities of that particular issuer is, if such actions cause property damage, subject to restraint or a fine or imprisonment of up to two years. A legal person is also held liable for the above acts to the same extent.'[214]

Civil law consequences of insider dealing are not very clear. Under the general principle of civil law, transactions violating the mandatory rules of the law are void.[215] This principle can be used to rescind contracts based on inside information. In addition, as was seen earlier, the supervisory authority has the power to bring class actions in court.

214 Criminal Code, art 217.
215 Civil Code, art 1.80.

Furthermore, as the rules relating to insider dealing are also effectively addressed to market professionals, they are additionally subject to the Stock Exchange Trading Rules and Code of Ethics.

Market Manipulation

Rules prohibiting market manipulation were introduced by the 1998 revision of the Public Trading in Securities Act. The Securities Market Act has slightly revised the concept of market manipulation. Under the Financial Instruments Markets Act,[216] it is prohibited to disseminate false, misleading, or incomplete information relating to the issuer, its securities, directors, activities, financial condition, or transactions in its securities. It is also prohibited to enter into securities purchase or sale transactions and give orders to buy or to sell securities, where such transactions or orders to trade would give false or misleading signals as to the supply of, demand for, or price of securities.

Similarly, as in the case of insider dealing, intermediaries are prohibited from rendering services in a transaction where they have information that such a transaction would lead to market manipulation. Consequently, intermediaries are also subject to the requirements prescribed by the Stock Exchange Trading Rules and Code of Ethics.

Legal consequences for violation of such a requirement are the same as those applicable to insider trading. However, the Criminal Code imposes criminal liability only for dissemination of false, misleading, or incomplete information, and does not deal with transactions or orders to trade which give false or misleading signals as to the supply of, demand for, or price of securities:

> 'A person who disseminates false, inaccurate, or incomplete information about the issuer or the securities of that particular issuer for the purposes of seeking to unreasonably boost and unreasonably cut the market price of the securities, and thereby inflicts property damage, is subject to restraint or a fine or imprisonment of up to three years. A legal person is also held liable for the above acts to the same extent.[217]'

Public Take-Over Bids (Tender Offers)

There are two types of tender offers under Lithuanian securities laws, ie, voluntary and mandatory.

Under the Securities Act, if a person, acting independently or in concert with other persons, acquires more than one-third of the votes at the general meeting of shareholders of an issuer, he must:

- Dispose of the securities exceeding the threshold; or

216 Markets in Financial Instruments Act, art 63.
217 Criminal Code, art 218.

- Submit a mandatory tender offer to buy the remaining voting securities and securities granting the right to acquire voting securities of the issuer (eg, warrants).[218]

Persons acting in concert are defined as natural or legal persons who cooperate with the offeror or the target company on the basis of an agreement, either express or tacit, oral or written, aimed at acquiring the control of the target company granting 1/3 or more of the votes in the general meeting of shareholders of the target comany or at frustrating the successful outcome of the bid. Persons controlled by another person, and persons acting in concert with that other person, shall also be deemed acting in concert with one another.

The price of an offer must be stated in such an offer. It must be registered with the supervisory authority. The mandatory tender offer price may not be less than the highest price of the securities that the offeror has acquired over the last 12 months before exceeding the one-third limit. Notwithstanding this rule, each shareholder of an issuer is entitled to claim in court the increase of the mandatory tender offer price up to the fair price of such securities.

Furthermore, if the offeror acquires additional securities at a price higher than the price of the offer within one year following the implementation of the tender offer, both in case of the mandatory and voluntary tender offer, he is obliged to pay the balance to the persons having accepted the offer.

From the moment of exceeding the mentioned threshold, the person (or group of persons acting in concert) is deprived of all votes at the target company's shareholders' meeting, until the take-over offer is registered with the supervisory authority or such person transfers a certain amount of such securities, so that the number of votes is reduced to below the one-third limit. It appears that loss of the votes is the only consequence for the failure to comply with the mandatory tender offer requirement.

As mentioned, tender offers must be registered with the supervisory authority.[219] For purposes of registration, the offeror must deliver certain documents, among which are a circular prepared in a prescribed form. All tender offers must be exercised on the exchange (ie, regulated market), and they are subject to Stock Exchange Trading Rules, regardless of whether securities are listed by the exchange.

Execution of an offer must be commenced on the fourth business day following registration of the offer with the supervisory authority. An offer must remain open for a period not shorter than 14 days, but not longer than 70 days.[220] In voluntary offers, consideration may be paid either in cash or in

218 Securities Act, art 31.1.

219 Rules on preparation and approval of a circular, and implementation of a Tender Offer, approved by the Resolution of the Board of the Bank of Lithuania on 28 February in effect as from 9 March 2013, *Zin* (2013), no 25-1254.

220 Securities Act, art 33.

other registered securities. In mandatory offers, consideration can only be paid in cash.

As soon as the target company has been notified of a pending offer, its managing bodies may not take any action to frustrate the offer or hinder the investors' opportunity to consider the offer. The Securities Act exempts certain situations from the mandatory tender offer requirement.[221] By the end of 2013, the following situations had been exempted:

- The party acts in concert with another person in respect of whom the obligation arises later;
- The threshold is exceeded because all of the issuer's securities or part thereof are exchanged for the securities of the newly incorporated company in proportion to the authorised capital of the issuer under the reorganisation or the split-off issuer and the person had previously executed the takeover bid or had been exempted from the obligation to submit a takeover bid although he had exceeded the threshold in respect of which the obligation to announce a takeover bid arises;
- The threshold is exceeded where the company that had been reorganised by way of splitting or from which a new spin-off company is established had previously implemented the takeover bid or was exempted from the obligation to implement the bid although it had exceeded the threshold of the votes giving rise to the obligation to submit a bid, and the securities held thereby are transferred to the companies established following the splitting of the company;
- The threshold is exceeded in accordance with the Law on Restructuring of Enterprises of Lithuania under the restructuring plan of the issuer;
- The threshold is exceeded through the acquisition of the securities from the controlled or controlling person; this exemption is applied only as long as the relation specified in this item between the seller and the purchaser is maintained;
- The threshold is exceeded by acquiring the securities when the mandatory bid is executed in connection with other persons and the threshold is exceeded personally; and
- The party who has acted independently or in concert with other persons and has submitted a voluntary bid to acquire all securities of the offeree company acquires more than one-third of the votes in the general meeting of shareholders of such company.

Periodic Disclosure

In General

Reporting Issuer. In the sense of the Securities Law, all securities issuers are the 'reporting issuers'. They are subject to periodic disclosure requirements,

221 Securities Act, art 32.

according to which they must submit to the supervisory authority an annual report and periodic reports (which are quarterly and semi-annual).[222] At the same time, the same reports must be delivered to the Central Information Database.[223]

The supervisory authority determines the information to be disclosed in the annual and periodic reports. An annual report must be accompanied by the independent auditor's report on the compliance of the issuer's accounting and financial statements with Lithuanian laws, general accounting standards, or international accounting standards.

Annual and other periodic reports must include financial statements drawn up in accordance with the requirements prescribed by Lithuanian laws and general accounting requirements. Financial statements must be accompanied by an explanatory statement.

Annual and other periodic reports must comply with the forms prescribed by the supervisory authority. The information required is very extensive. If the issuer considers some information as being confidential, it may skip that item and apply to the supervisory authority for permission not to disclose such information.

However, the supervisory authority may require the issuer to prove that disclosure of such information may cause significant damage to the issuer or that it would be contrary to public interest. The supervisory authority may nonetheless instruct the issuer to publish such information if, in its view, such a disclosure would not cause significant damage to the issuer and the non-disclosure of information would mislead the investors.

All issuers must submit annual reports and periodical reports for three, six, nine, and 12 months. Additional reporting can be asked due to the essential events related to the issuer's financial status, trade securities, or material events.

An annual report must be submitted within one month after the annual shareholders' meeting; periodical reports must be submitted within two months after the end of the reporting period.

The issuer must make it possible for all owners of its securities to familiarise themselves with the reports free of charge. Such information is to be published in the central information database. Issuers whose securities are listed on the Official or Secondary List of the Stock Exchange are also obliged either to publish their reports, or to publish information on where and when the investors may familiarise themselves with such reports.

Foreign Issuers. Based on Directive 2001/34/EC (as amended), the Rules on Periodic Disclosure of Information and the Law on Securities provide reporting

222 Securities Act, art 20.

223 Rules on Annual and Periodic Information Disclosure Rules, approved by the Resolution of the Board of the Bank of Lithuania of 28 February 2013, *Zin* (2013), no 25-1255.

requirements applicable to the issuers whose securities are listed in EU member states. The governing rules also cover reporting requirements as regards issuers based in foreign (non-EU) states.

Articles 21 and 22 of the Law on Securities provides that the annual (interim) financial statements and annual (interim) consolidated financial statements of issuers established in member states must be drawn up in observance of the requirements of the national legal acts of the member state where the issuer has been established. The annual financial statements and annual consolidated financial statements of the issuers established in non-member states must be drawn up in observance of the international accounting standards or the universally accepted accounting principles. In the event that interim financial statements and interim consolidated financial statements have been drawn up not in observance of the international accounting standards, interim financial statements and interim consolidated financial statements must comprise at least an abbreviated balance sheet, an abbreviated profit and loss account, and an explanatory note.

Rules on Periodic Disclosure of Information[224] set forth the specific requirements as regards non-EU issuers. The annual financial statements and annual consolidated financial statements of such issuers have to clearly indicate that they have been prepared in accordance with universally accepted accounting principles, or that accounts have been prepared in accordance with accounting principles of Japan, the United States of America, the People's Republic of China, Canada, Republic of Korea and, for the financial year beginning 1 January 2015 — accounting principles of the Republic of India. As of the date these countries denounce their accounting principles in favor of universally accepted accounting principles, the applicability of accounting principles of the aforementioned countries is immediately suspended.

Reporting Material Events

On the happening of any material event, the reporting issuer also is under the duty to promptly deliver an information notice to the operator of the regulated market at which the securities issued thereby are being traded, the supervisory authority, and make public and post in the central storage facility an information notice on each material event, with the exception of events specified in the Securities Act.[225] Such an information notice must specify the nature of the event and provide a short description.

The duty is mitigated by the exemption allowing the issuer to decide that publication of information may cause it financial damage, in which case the issuer must forward information only to the supervisory authority, marking it as confidential.[226] Each material event must be reported within 24 hours.

224 Rules on Periodic Disclosure of Information, art 16.
225 Securities Act, art 18.
226 Securities Act, art 18.2.

A 'material event' is understood as 'any event directly relating to the activities of the issuer of which the issuer is aware or must be aware, which is not of public knowledge, and which may lead to substantial movements in the prices of its securities'.[227] The Rules on Disclosure of Material Events provide a non-exhaustive list of events that are, by their nature, considered as material events. These include:

- Management decisions on changing the amount of the authorised capital;
- Management decisions to change the characteristics of securities, to buy up own securities, and to issue securities;
- Management decisions to pay dividends;
- Management decisions to file an application with the stock exchange for listing the issuer's securities on the stock exchange;
- Management decisions to change the members of the issuer's managing bodies, the audit firm, or the inspector;
- Management decisions to reorganise or liquidate the issuer;
- Management decisions to file a bankruptcy petition;
- Management decisions to establish a subsidiary or a branch;
- Management decisions to change the type of the main activity;
- Calling of the general meeting of the issuer's shareholders;
- Court decisions to start bankruptcy proceedings against the issuer or a decision of the meeting of creditors to settle the issuer's bankruptcy case out of court;
- Decisions of competent authorities to restrict the issuer's activity, or suspend or revoke authorisation (license) to engage in the main activity;
- Failing to meet certain requirements relating to capital and reserves of the issuer, as prescribed by relevant statutory acts;
- Conclusion, cancellation, declaring void, or other expiration of validity or suspension of execution of contracts on the transfer of the issuer's long-term high-value assets;
- Conclusion, cancellation, declaring void, or other expiration of validity or suspension of execution of large contracts (trade, credit, and the like) that have or might have material effect on the issuer's activity and financial state;
- Natural calamities and social unrest (strikes, fire, and the like) which have direct influence on the issuer's activity; and
- Decisions on significant guarantees, increase of debt, material litigation, or arbitration. The list is not exhaustive. In every instance, it is the issuer who must decide whether the event is to be considered as material. Failure to notify a material event imposes on the issuer administrative liability. The

227 Rules on Disclosure of Material Events, arts 6 and 9.

Commission may impose a fine on the issuer of up to LTL 200,000.[228] In addition, a concept of a material event serves as a basis for a determination of insider trading.

Squeeze-Out and Mandatory Sell-Out

Starting from 1 January 2005, the new rules for squeeze-outs and mandatory sell-outs were implemented in the Securities Market Act[229] and therefore it is now implemented in the Securities Act.[230] Under the mandatory change of shareholders' rules, the shareholder of an issuer in the sense of the Securities Act, acting independently or in concert with other persons and having acquired shares representing not less than 95 per cent of the total votes at the general meeting of shareholders of the issuer, shall have a right to require that all the remaining shareholders of the issuer sell the voting shares owned by them, and the shareholders shall be obligated to sell the shares in the manner established by the present law. Where the shareholder purchases shares acting independently or in concert with other persons:

- Persons acting in concert will be jointly liable for the fulfillment of the obligation to acquire the shares; and
- The number of shares acquired by persons acting in concert shall be proportionate to the number of votes of the issuer held thereby at the moment of the submission of the notification unless the agreement concluded by persons acting in concert provides differently.

Where a shareholder acting independently or in concert with other persons is obligated to submit a mandatory tender offer, the sale and purchase of shares in accordance with article 19 (37 under the Securities Act) may be executed only after the shareholder's obligation to submit the mandatory tender offer is fulfilled in the prescribed manner.

The price offered for the shares during the squeeze-out procedure must be fair. Neither the Securities Act nor other legislation prescribe in detail how fair price must be calculated.

Nonetheless, the Securities Act provides general principles for 'fairness of the price'. In particular, the fair price of shares must be established in accordance with the following principles:

- Where the shareholder, acting independently or in concert with other persons and having acquired not less than 95 per cent of votes in the general meeting of shareholders of the issuer, submits a mandatory tender offer, the fair price will be the one paid to him for the shares of the issuer while acquiring the shares in this manner (only provided not more than three months have elapsed

228 Markets in Financial Instruments Act, art 95.
229 Securities Market Act, art 19(1).
230 Securities Act, art 37.

from the moment of the expiry of the tender offer until the submission of the notification for the squeeze-out);

- Where a shareholder, acting independently or in concert with other persons and having acquired shares entitling it to not less than 95 per cent of votes at the general meeting of shareholders of the issuer, submits a voluntary tender offer, the fair price will be the one paid to the shareholder for the shares of the issuer while acquiring the shares in this manner, provided through the tender offer the bidder acquired not less than 90 per cent of tendered shares (only provided not more than three months have elapsed from the moment of the expiry of the tender offer until the submission of the notification for the squeeze-out); and
- In other cases, the price of the shares will be established in the manner opted by the person acquiring the shares and ensuring a fair remuneration for the shares being purchased.

On receipt of the notification of the shareholder buying up the shares acting independently or in concert with other persons, the issuer shall not later than within five days notify of the purchase of the shares by registered mail each shareholder, the supervisory authority, and the National Stock Exchange and publish an appropriate announcement in the Lithuanian national daily specified in the by-laws of the issuer, which publishes all announcements. The announcement shall indicate information specified by the law.[231] Within 90 days from the date of the announcement of the notice in the Lithuanian national daily newspaper specified in the by-laws of the issuer, all shareholders will be obligated to sell their shares to the shareholder indicated in the notice on the buy-up of shares, acting independently on in concert with other persons, or contest the price proposed for the shares in the court.

Where, within the prescribed term, the shareholder fails to sell the shares and does not contest the proposed price for the shares on the last day of the time limit, the shareholder buying up the shares will be deemed to have acquired the right to necessarily buy up the shares by transferring the proposed price for the shares into the account indicated by the shareholder or the depository account. The settlement for the shares being bought up shall be made only in cash. Where the shareholder buying up the shares fails to pay the proposed price for the shares within the established time limit, it will be deemed that the shareholder's right for the squeeze-out has elapsed.

Any shareholder of the issuer in the sense of the Securities Act will have a right to require the shareholder who, acting independently or in concert with other persons, has acquired the shares entitling it to not less than 95 per cent of all votes in the general meeting of shareholders of the issuer, to purchase the voting shares owned by him and the shareholder concerned must buy up the shares. In this case, the shareholder who requires selling of the shares must submit an appropriate notice to the issuer.

231 Securities Act, art 37.9.

Where a shareholder requires that another shareholder, acting independently or in concert with other persons and who has acquired shares entitling it to not less than 95 per cent of votes in the general meeting of shareholders of the issuer, purchases the shares of the shareholder, the above-mentioned provisions will apply *mutatis mutandis*.

Luxembourg

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Luxembourg

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Introduction

Preliminary Observations

Luxembourg securities laws deal specifically with shares, debentures, bonds, and other financial instruments able to create liquidities for the issuing companies. Regulating the issuance of such instruments is of paramount importance, especially in a growing international financial market. Although there are certain countries where foreign or international securities are regulated separately from domestic securities, this is not the situation in Luxembourg. Because the Luxembourg domestic market is of relatively minor importance when compared to the international financial market, Luxembourg, in its regulation of securities, does not make a distinction between foreign and domestic instruments.

Obviously, apart from the issuance of financial instruments on a public level, there are always transactions of securities between private parties which have nothing to do with the public market. Those private transactions are governed by the basic concept of contractual freedom. It is obvious that, if a company issues shares, bonds, or debentures, the statutory corporate bodies having the authority to do so must take the relevant decisions in the manner and in the format as required by law. Commercial transactions on such instruments between two private parties are not specifically regulated whether those are instruments issued by Luxembourg domiciled companies or by foreign companies and sold in Luxembourg.

The public market of international securities consists of course in the official Stock Exchange. The Law of 30 December 1927 created what was called at the time a 'Commercial Exchange' (*Bourse de Commerce*). Article 3 of the Law of 30 December 1927 provided that securities would be dealt with at this exchange. The Decree of 22 March 1929 entrusted the organisation and management of the Stock Exchange to a company to be specifically incorporated under the name of *Société de la Bourse de Luxembourg* (Stock Exchange Company of Luxembourg). The *Société de la Bourse de Luxembourg SA* was incorporated on 5 April 1929, and the articles of incorporation can be consulted in the *Official Gazette*.[1] The articles of incorporation were amended on 26 April 1989 and 24 April 1991.

1 *Mémorial* C 1928, at p 319.

Whereas the Luxembourg Stock Exchange was always under the supervision of a representative of the government under the name of *Commissaire à la Bourse*, Directives issued by the then European Community (EC), and now European Union (EU), required important transformations in law and regulations in the early 1990s. In anticipation, the *Société de la Bourse de Luxembourg* enacted specific regulations on 27 June 1985. The Law of 21 September 1990 introduced the EC Directives into domestic law, abrogated the Law of 30 December 1927, and created the possibility of multiple stock exchanges. It also created a proper authority under the name *Commissariat aux Bourses*, which was under the direct control of the President of the government and whose job it was to supervise the *Société de la Bourse de Luxembourg*. At the same time, the organisation and management of the Luxembourg Stock Exchange was extended in favour of the *Société de la Bourse de Luxembourg* until 21 March 2027, under the control of the *Commissariat aux Bourses*. The Law of 23 December 1998 created a new authority under the name of *Commission de surveillance du secteur financier*, the legal successor to the *Commissariat aux Bourses*.

Whereas, in earlier years and since 1945, the issuance and public offering of securities were under the control of the head of the Banking Supervision (*Commissaire au contrôle des Banques*), the Decree of 28 December 1990 requires for the admission of any security to the Luxembourg Stock Exchange, as well as for any public offering of securities, the filing and publication of a prospectus under the supervision and control of the *Commissariat aux Bourses*.[2] The Law of 4 December 1992 regulates the information and details which are to be disclosed in case of substantial holdings.

Legal Sources

Further to the laws and regulations referred to above, reference should be made to:

- The Company Law of 10 August 1915, as amended;
- The Law of 3 May 1991, regulating insider trading; and
- The Grand-Ducal Decree of 17 February 1971, as amended, governing transactions on securities.

Authorities

Whereas the regulation of the Luxembourg Stock Exchange lies within the responsibility of the *Société de la Bourse de Luxembourg*, this company, organised as a private limited-liability company (*société anonyme* or SA), is supervised by the *Commission de surveillance du secteur financier*, which is organised by the Law of 23 December 1998 and which, in general terms, supervises the Luxembourg Stock Exchange under the authority of the government.

In a very general way, the *Commission de surveillance du secteur financier* has the authority to investigate and report on applications for admission of new stock exchanges and to supervise those bodies managing the said stock exchanges, to supervise the files

2 The entity now is the *Commission de surveillance du secteur financier.*

relating to stock exchange problems on an international and EC level and to represent the government in negotiations with respect thereto, to exchange information with the supervising public authorities and to recommend to the government all ways possible to improve the legal environment regulating the Luxembourg Stock Exchange, as well as to analyse and report on all other issues on which the government requests its advice.

This authority includes the right to veto all decisions made by the relevant stock exchanges and in general to supervise compliance with laws and regulations by all bodies involved in the operation of the Luxembourg Stock Exchange, as well as to control prospectuses dealing with public offerings for which a quotation on the Luxembourg Stock Exchange will not be required. The *Commission de surveillance du secteur financier* and the members of its staff are bound by rules of professional secrecy sanctioned by criminal laws. Obviously, the professional secrecy rules do not prevent the *Commission de surveillance du secteur financier* from making to national or foreign authorities such communications required by the supervision, on condition, however, that the said information will be protected by the secrecy rules governing the receiving authority. No tax or duty is levied on transactions on the Luxembourg Stock Exchange.

Procedures

It is obvious that a company purporting to raise funds by public offering of securities must comply with company laws and regulations, as well as with its own articles, for authorizing and issuing the said securities. It is certain also that, in case of a merger between two companies where a public offer of purchase of shares is launched as to the shares of one of the two companies, there are particular rules and laws to be complied with.

The purpose of this chapter is not to enter into the details of those matters pertaining to company law or to special rules relating to mergers, but only to deal with the general aspect of the public issuance of securities. If a public offering of securities is considered, this issuance may be with listing and quotation at the Luxembourg Stock Exchange or without such a listing.

Regarding listing on the Luxembourg Stock Exchange, the law requires that the issuer file with the *Société de la Bourse de Luxembourg* a prospectus, the contents of which are regulated in detail by the Decree of 28 December 1990. By this prospectus, full particulars of the issuer, as well as with respect to the nature and to technical details of the securities, are to be disclosed. This prospectus must obtain the approval of the *Société de la Bourse de Luxembourg*. In case of no response within six months of filing, this lack of response is deemed as being a refusal of authorisation. A recourse against a formal or implicit decision of refusal may be filed with the member of the government having within his attributions the Treasury Department. In no circumstances may the approval or visa by the *Société de la Bourse de Luxembourg* be referred to in any documentation.

Regarding public offering but without listing on the Luxembourg Stock Exchange, a different prospectus must be filed with the *Commission de surveillance du secteur financier* for authorisation. The contents of this different prospectus are also regulated

by the relevant law. The procedure in general terms is similar to the one governing the prospectus in case of listing at the Luxembourg Stock Exchange. In addition, obviously all rules of normally applicable law are to be complied with in case of sale and purchase of securities.

Organisation of Security Market and Regulations

In General

As has been said above, Luxembourg law does not make any distinction between securities publicly offered which are to be sold by a domestic entity or by a foreign issuer. In all cases, the ordinary and normally applicable regulations must be complied with as well as when domestic securities are publicly offered by a Luxembourg seller or when international aspects are involved.

Marketing of Securities

Source of Regulation

Regarding participants in the securities market, the articles of association of the *Société de la Bourse de Luxembourg*, as well as the regulations issued by this company, govern the admission of participants to the market of publicly offered securities. While the law provides for possible admission of more than one stock exchange, there presently is only the Luxembourg Stock Exchange, as managed by the *Société de la Bourse de Luxembourg*.

Rules and Reciprocity

In General. The listing of international or foreign securities, generally, is governed by the same rules as the listing of domestic securities. In addition, the same rules apply to foreign issuers and to nationals, all this without any requirement of reciprocity by the foreign state of which the foreign issuer is a national or a resident.

However, the fact that Luxembourg is a member state of the EU may have as a consequence that different rules may apply, depending on whether the supervisory or stock exchange authorities of an EU member state have already dealt with certain securities. Specific requirements will be highlighted hereafter.

Requirements as to Issuer. The requirements regarding the issuer of securities to be listed are governed by the regulations of the *Société de la Bourse de Luxembourg*. They may be indicated as follows:

- The capitalised value of the share capital of the issuer, inclusive of its last financial year, must be at least €1,239,467.6;[3]

3 It is within the discretionary authority of the board of directors of the *Société de la Bourse de Luxembourg* to exempt a company from this requirement.

- The issuer must have been validly incorporated, be in legal existence, and be operated in accordance with the law and regulations; and
- The company must have been in existence for at least three years or must have filed its annual financial statements for the last three financial years.[4]

Requirements as to Securities. Under the regulations of the *Société de la Bourse de Luxembourg*, it is possible to list on the Luxembourg Stock Exchange only shares, bonds, and debentures, as well as some derivative rights.[5]

Shares. The shares must have been validly created and issued under the laws and regulations governing the issuer. The shares may not be restricted, but must be freely transferable. Apart from other restrictions which will prevent shares from being listed, this means that only shares completely paid in may be listed. By exception to this rule, the board of directors of the *Société de la Bourse de Luxembourg* may exempt an issuer from this condition if sufficient guarantees are deemed to be given that the shares are, as a matter of fact, freely transferable.

In case an earlier public offering of shares has been made for which the period of validity has not yet expired, shares can be listed at the Stock Exchange only after the said period of public offering will have expired. In a general way, the shares must be publicly held within the member states of the EU. This condition is deemed to be fulfilled if at least 25 per cent of a given type of shares are so held by the public. This percentage may be reduced if it is considered to be impossible that such a percentage be reached given the number of issued shares.

It also is required that a complete block of the share capital or even all the shares of a given type be listed in one move and that the public be informed of the quantity of shares so listed and the number of shares retained. The public must have all necessary information as to the internal controlling structures organised within the issuing company. The shares must materially exist and be incorporated in transferable documents. However, it is admitted that, for shares issued by a member state of the EU, only national requirements for those shares must be met, on condition, however, that thereby the public interest is duly protected.

For foreign (non-EU member state) shares to be admitted to the Luxembourg Stock Exchange, it is required that they first are listed on the national stock exchange of the issuing company. If, however, this condition is not met, the board of directors of the *Société de la Bourse de Luxembourg* may exempt from the requirement, on condition, however, that it considers to have sufficient guarantees that the non-listing on the

4 Under certain conditions, the board of directors of the *Société de la Bourse de Luxembourg* also may exempt an issuer from this requirement.

5 It is to be noted in general terms that the board of directors of the *Société de la Bourse de Luxembourg* may impose additional conditions for listing or, indeed, refuse a requested listing if it considers that the interest of the public is not duly protected.

national stock exchange of the issuing company does not disclose an attempt to withhold publicly needed information.

Bonds and Debentures. For the listing on the Luxembourg Stock Exchange of bonds and debentures, the conditions relating to public holding of shares and to listing on the national stock exchange of the issuing company (for non-member states of the EU) are not applicable. For listing of bonds and debentures, it is required that the total raising of capital by way of the debentures is at least €247,893.52. This condition obviously does not apply in case of ongoing issuance and if the total amount of the capital to be raised is not set in advance.

Bonds and debentures convertible into ordinary shares or exchangeable against ordinary shares or warrants may be listed on the Luxembourg Stock Exchange only on condition that the corresponding shares have been admitted to a regulated public market prior to or at the same time as the listing of the debentures is requested. Again, and on condition that the information relating to the debentures is deemed to be sufficient for a full disclosure to purchasers of the precise value of the debentures to purchasers, the board of directors of the *Société de la Bourse de Luxembourg* may be exempt from this requirement.

Debentures Issued by Government. The listing of government debentures is beyond the scope of this chapter and will not be dealt with here.

Requirements as to Prospectus and Procedure. As noted above, as a condition to the admission to the Luxembourg Stock Exchange, a prospectus must be filed with the *Société de la Bourse de Luxembourg* and must be approved by this company and by the *Commission de surveillance du secteur financier*. The contents of the prospectus are regulated by EC Directives, which have been integrated into Luxembourg law. In short, the following information must be disclosed in the prospectus:

- A copy of such documents as are required to be filed with the Luxembourg Companies Registrar in accordance with the Companies Act of 10 August 1915 and containing a complete disclosure of the company;
- Contractual agreements relating to the shares to be listed;
- The articles of association of the issuing company, as well as of any company guaranteeing reimbursement of bonds or debentures, together with a copy of the financial statements for the last three years prior to the application;
- A specimen of the securities to be listed on the Luxembourg Stock Exchange;
- Documents pertaining to the company and to the shareholders' decision to issue the securities; and
- If there is listing of the securities on the stock exchanges of one or more other EU member states, a certificate of compliance with the regulations of the stock exchange.

Again, it is to be noted that the board of directors of the *Société de la Bourse de Luxembourg* may require further conditions to be met in the interest of transparency and

protection of the public. The procedures governing the filing of the prospectus are provided by the Decree of 28 December 1990.

Prior to any public offering, the issuer must file a prospectus with the *Société de la Bourse de Luxembourg*. This filing must be done at least 15 days in advance. If the *Société de la Bourse de Luxembourg* considers that the interests of the public are not duly protected by the required disclosure, it may prohibit the public offering. The *Commission de surveillance du secteur financier* has a similar right, under certain conditions, to prohibit a listing at the Luxembourg Stock Exchange.

No prospectus is required if a company requests admittance to the Luxembourg Stock Exchange of securities within three months of a public offering duly made. In a public offering without listing at the Luxembourg Stock Exchange, the issuer has certain obligations to disclose information, but there is no requirement of filing of a prospectus with the *Société de la Bourse de Luxembourg*. The disclosure obligations in question will be dealt with at a later stage.

In general terms, the purpose of the prospectus is to disclose to the interested public such information as it is entitled to know to enable it to come to an educated decision as to a possible investment. To warrant a sufficient disclosure, the Decree of 28 December 1990 provides for certain models to apply to disclose information. Under exceptional circumstances and if the disclosure risks serious jeopardy to the issuing company, the *Commission de surveillance du secteur financier* may exempt it from disclosing certain information. If, however, the *Commission de surveillance du secteur financier* considers that additional information is required to fully inform interested investors, it also may require the issuer to disclose additional information. Once the prospectus is approved by the authorities, it will be published together with the publishing material in possible newspapers and also in the brochures relating to the issuance.

Luxembourg being a member state of the EU, it may happen that an issuing company of another member state may apply to be admitted at the same time or within a very short period of time to the stock exchanges of Luxembourg and of one or more other member states. If an approval of a prospectus has already been obtained in another EU member state, the issuing company may request that the *Commission de surveillance du secteur financier* approve the prospectus used and approved in the other member state. Regarding applicable law, and if the issuing foreign company has applied for listing of the securities in its national member state, it is this national law which must be complied with for drafting the prospectus. If, however, the issuing foreign company does not apply in its national member state, it may opt as to the law which it wants to comply with.

If a prospectus has been approved of for public offering in another member state of the EU, the *Commission de surveillance du secteur financier* will recognize this prospectus for admission of securities to the Luxembourg Stock Exchange.[6]

6 The details as to disclosure by way of the prospectus are contained in the Decree of 28 December 1990. English and German versions of the disclosure requirements may be obtained from the *Société de la Bourse de Luxembourg*.

Registration of Public Offerings

Obviously, listing securities at the Luxembourg Stock Exchange is one of two ways of making a public offering of securities. It requires no further formalities than those indicated above. Another way of making a public offer consists of making a public offering short of applying for listing at the Luxembourg Stock Exchange. In this case, the company obviously is not required to comply with the requirements for listing. The public offering then is dealt with more specifically by the Companies Act of 1915 and, in particular, by articles 33–36 and 80–83 of the Companies Act.

Whoever wants to publicly offer shares, founder shares, bonds, or other securities relating to property rights in a company must file with the Companies Registrar a notice which contains the information essential for protection of the public and for assuring a fair environment for the public offering. The notice, similar to the prospectus required in the case of a listing on the Luxembourg Stock Exchange, but with less detail, must disclose information relating to:

- Incorporation of the company;
- Structure of the share capital;
- Financial statements;
- Organisation and memberships of the board of directors; and
- Information relating to the nature and the technical aspects of the securities being offered.

This notice (*Notice descriptive*) will be published, together with all publicity material relating to the public offering. In the case of a public offering made by a foreign company, the company must file its articles of incorporation with the Companies Registrar, along with all required documents as would need to be filed by a Luxembourg company in accordance with Luxembourg law.

Periodic or Ongoing Disclosure

In the case of listing at the Luxembourg Stock Exchange, issuers of both shares and bonds must disclose, on an ongoing basis, important information having a material impact on the value of the shares or bonds listed, as well as on the rights attached to the shares or debentures or, in the latter case, with respect to the loan represented by the debentures. The issuing company also must inform the public if a new loan by way of debentures is raised, as soon as such a loan will be admitted to the Luxembourg Stock Exchange. In the case of companies of other member states of the EU, they must disclose in Luxembourg each and every change in substantial holdings in the country as they would have to do in their country of origin. The disclosure with respect to substantial holdings will be governed by their national law. Regarding companies of foreign countries being non-EU states, they must disclose any change in substantial holdings each time certain preset levels in percentages of voting rights are exceeded, and this within nine days of the relevant event.

In general, and in accordance with the regulations issued by the *Société de la Bourse Luxembourg*, a company (other than an open-end investment fund) must disclose on a bi-annual basis a note on its activity and financial situation. This note must be disclosed within four months of the end of the period and must provide the turn-over and the net result after tax. In the case of consolidated accounts, the company may opt between bi-annual notes on a consolidated or non-consolidated basis.

In the case where a company having its registered office in a non-EU state publishes in its home country a bi-annual report, the *Commission de surveillance du secteur financier* may accept that the company will publish this report instead of a specifically Luxembourg-oriented report. Again, there are no specific distinctions made between domestic Luxembourg companies and foreign companies, except for those which may result from EU regulations.

Specific Rules

Disclosure of Substantial Holdings

Disclosure of substantial holdings is governed by the Law of 4 December 1992 and the Law of 23 December 1998, which apply to any person obtaining or having a substantial holding in a Luxembourg company, the shares of which are in part or in total listed at the stock exchange of any EU member state. The duty of disclosure is triggered each time when the total voting rights in the Luxembourg company pass a threshold of 10 per cent, 20 per cent, 33.33 per cent, 50 per cent, or 66.66 per cent of the voting rights, whether by way of exceeding such a threshold or by way of decreasing below the threshold. The acquisition of voting rights referred to by the law may be any type of acquisition. The law obviously does not apply to UCITS or to brokers in so far as they do not intervene in the management of the company.

The Law of 4 December 1992 and the Law of 23 December 1998 require that any person having or controlling voting rights in the above proportions must comply with the disclosure duty, whether the rights are held in person or through nominees or legal entities. The duty of disclosure is to be satisfied with respect to both the company involved and the *Commission de surveillance du secteur financier* within seven days of the event of acquisition or loss of the substantial holding threshold or within seven days after the person or entity involved is deemed to have had the said knowledge.

Within nine days from the declaration by the shareholder to the company in which the relevant percentage of shares is held, the latter must proceed to its own disclosure. If disclosure is to be made, it is to be made to all EU member states where the shares of the company are listed on the official stock exchanges. If the disclosure is not made, the voting rights in question are suspended and may not be exercised.

Insider Trading and Fraud

The concept of a criminal offence for insider trading was introduced into Luxembourg law by the Law of 3 May 1991, which was enacted following the EC Directive of 13 November

1989. For insider trading to be a criminal offence, it is required that a person uses for his benefit or the benefit of another person precise information not publicly available as to the issue or as to certain securities of the issuer, such that this confidential information may have a material impact on the present value of the securities or on their value in the near future.

The territorial link to Luxembourg enabling Luxembourg prosecuting authorities and courts to retain jurisdiction over this offence results from the purchase or sale on the Luxembourg Stock Exchange of securities on the basis of insider knowledge, or from the fact that insider knowledge is gained or disclosed to a third party in Luxembourg to be used for trading in a foreign country. As soon as such a link with Luxembourg is given, Luxembourg authorities may prosecute.

In compliance with the Law of 19 February 1973 and the Law of 5 April 1993, as amended, and a ruling by the Luxembourg Monetary Institute (*Institut Monétaire Luxembourgeois*) of 7 November 1989 with respect to money laundering, all transactions over the Luxembourg Stock Exchange give rise to a duty to disclose the beneficially interested parties. The broker or financial institution having such information must advise the District Attorney if it considers that there are grounds for suspicion under the rules. The District Attorney may decide to investigate any insider trading offence, as well as any money-laundering offence. The *Commission de surveillance du secteur financier,* having the power of supervision over the Luxembourg Stock Exchange, may hand any relevant information over to the District Attorney.

In the case of an investigation by non-Luxembourg official authorities, there are channels for communication and investigation within Luxembourg, either through the *Commission de surveillance du secteur financier* or through the Luxembourg investigating magistrate. These channels of investigation and/or communication are either regulated by bilateral or international treaties or will be dealt with on a case-by-case basis by the Ministry of Justice.

Public Take-Over Bids

Luxembourg law does not contain any specific regulation as far as public take-over bids are concerned.

Jurisdictional Conflicts

For a country with a small territory, but with economic and financial dealings and aspirations having a worldwide aspect, such as Luxembourg, issues of conflicts of law and of jurisdiction are important as international elements are frequently encountered. Therefore, the law of international conflicts has always been a key element in Luxembourg's legal structure, both in terms of conflict of law and in terms of conflict of jurisdiction. In matters of conflict of law, Luxembourg is a party to the Hague Treaty of 15 April 1958 and the Treaty of Rome of 1 July 1980.

In matters of jurisdictional conflicts, Luxembourg's law of conflicts is particularly based on the Brussels Convention of 27 September 1968, governing the recognition of judgments as between members of the EU, replaced by a CE regulation number 44/2001 of the council of 22 December 2000 concerning the judicial competence, the recognition and the execution of decisions in civil and commercial matters and the Treaty of Lugano of 16 September 1988, governing similar issues with other European countries. The interpretation and construction of the Brussels Convention is obviously a matter for the European Court of Justice in Luxembourg, whereas the other international treaties are construed and applied by Luxembourg courts in accordance with the Luxembourg international rules.

Regarding the administrative law dealing with international securities in the context of listing at the Luxembourg Stock Exchange or other situations arising from the supervision by Luxembourg authorities, and if a company or physical person wishes to take recourse against a decision by the authorities and where such recourse is admissible, it is to be taken before the Administrative Court (*Tribunal Administratif*), which was created by the Law of 7 November 1996 and which commenced its functions on 1 January 1997.

If civil or commercial courts have jurisdiction to sit in matters of private litigation between the concerned parties, these courts will apply Luxembourg procedural rules. Regarding applicable law, they will analyse whether a certain legal relationship is to be governed by Luxembourg law or by any foreign law, the contents of which are to be established in court. For this purpose, both international treaties and Luxembourg rules of conflict will apply. It is only in exceptional situations where Luxembourg's concept of public order prevents normally applicable foreign laws from being applied.

In the event of a criminal offence committed in Luxembourg, Luxembourg criminal courts will have jurisdiction as soon as a criminal offence has been committed in Luxembourg or a Luxembourg national has committed abroad a crime considered as such under Luxembourg law. Luxembourg criminal courts can only apply Luxembourg law as, by nature and essence, criminal laws are restricted to the territory of the sovereign state which they govern.

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Malaysia

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Introduction

In General

Malaysia has two stock exchanges, ie, the Kuala Lumpur Stock Exchange and the Malaysian Exchange of Securities Dealings and Automated Quotations Berhad, commonly known as MESDAQ Bhd.

The Kuala Lumpur Stock Exchange has, over the 100 years since its inception, grown to have more than 700 companies listed on its two boards, ie, the Main Board and Second Board. MESDAQ was only established in 1997, and it has only one company listed on its exchange.

The pioneering public-listed companies tended to be trading, plantation, or tin companies which had their origins in the United Kingdom, or were subsidiaries of the United Kingdom companies. After the independence of Malaysia in 1959, Malaysia embarked on a new economic policy, commonly known by its acronym, the NEP. The NEP seeks to eradicate poverty and attempts to restructure Malaysian society by re-distributing the economic pie more in line with the racial composition of the country. Hence, there is specific promotion of the Malay interest (which forms the majority of the populace which at that time was lagging in economic equality).

In the post-NEP decades, large privatised entities have emerged, such as Tenaga Nasional, Telekom Malaysia, and Petronas Dagangan. In addition, smaller-sized companies, which are mainly owner-dominated enterprises seeking new avenues for raising capital, also have dominated the numbers of listed vehicles in the Kuala Lumpur Stock Exchange.

With the onset of the Asian financial crisis in the late 1990s, the Kuala Lumpur Stock Exchange has seen its composite index taking a plunge from a 1,300-point high to a 300-point low. The government has taken great initiative to revive the capital markets, and plans are underway to ensure that the existing stockbroking companies with approximately 64 or so one-site broker houses of Malaysia merge into stronger and more efficient units able to face the onslaught of liberalisation, globalisation, and technology.

The Malaysian government, in December 1999, established a Capital Market Strategic Committee to assist in the development of a Capital Market Master Plan. The Capital Market Master Plan is a comprehensive plan that will chart the strategic positioning and future direction of the Malaysian capital market for the next 10 years.

Among other things, it will aim to address weaknesses in the capital market highlighted during the financial crisis in 1997–1999, provide a strategic road map to facilitate future business development, and assist in the creation of a resilient and competitive capital market. One should expect substantial revamping of the securities industries regulations in Malaysia in the near future.[1]

Regulatory System

Malaysia retained the British administration system after it gained independence in 1959. The Common Law concept is practiced in Malaysia, with corporate laws being modelled along the United Kingdom and Australian styles. Much of the provisions of the Companies Act are adopted substantially from the Australian Act. Cases from the commonwealth jurisdictions are not binding on Malaysian courts, but they would be persuasive.

The importation of English law relating to mercantile law generally continued under the Civil Law Ordinance 1956 where local legislation left lacunas. As local jurisprudence developed, much of these legislative gaps have been filled, rendering the importation of English law provisions somewhat superfluous.

Legal Sources

The sources of law that govern securities regulation in Malaysia broadly consist of the following:

- The Securities Industry Act 1983;
- The Securities Commission Act 1993;
- The Securities Industry (Central Depository) Act 1993;
- The Companies Act 1965; and
- The Futures Industry Act 1993.

There is much subsidiary legislation and various policies and guidelines that are issued pursuant to the above legalisation that will have an impact on securities regulations. The relevant guidelines that affect securities are mainly issued pursuant to the Securities Commission Act and are broadly the following:

- The Policies and Guidelines on Issue and Offer of Securities;
- The Guidelines for the Issue of Call Warrants;
- The Guidelines on Unit Trust Funds;
- The Guidelines for Public Offerings of Securities of Infrastructure Project Companies;
- The Guidelines for Public Offerings of Securities of Closed-end Funds;

1 The views expressed in this chapter are based on information available as at March 2000.

- The Guidelines on Asset Valuations for Submissions to the Securities Commission;
- The Guidelines on Property Trusts;
- The Guidelines on Loan Financing in Sale of Unit Trust Funds;
- The Guidelines on Delegation of Functions by Management Companies and Appointment of External Investment Managers;
- The Guidelines on the Establishment and Operation of Unit Trust Funds by Stockbroking Companies;
- The Guidelines on Transactions with Related Stockbroking Companies;
- The Guidelines on the Establishment of Foreign Fund Management Companies;
- The Guidelines on Securities Lending and Borrowing in Malaysia;
- The Guidelines for Application for Licences under the Futures Industry Act 1993; and
- The Malaysian Code on Take-overs and Mergers 1987 and its Practice Notes.

In addition to the above, there also are other legislation and policy guidelines (which may not have the force of law, but non-compliance with which may have extra-legal consequences) that directly affect foreign interests in Malaysian securities. These would include the Exchange Control Act and the Foreign Investment Committee Guidelines (see text, below).

The Authorities

Securities Commission

Prior to establishment of the Securities Commission in 1993, there was no single authority in Malaysia that was entrusted with the responsibility of regulating and systematically developing the capital market. Supervisory powers were shared between industry organisations like the stock exchange and government institutions.

The Securities Commission was established pursuant to the Securities Commission Act 1993 to streamline the regulatory structure of the capital markets. It is a self-funding statutory body with investigative and enforcement powers. It reports to the Minister of Finance, and its accounts are tabled in Parliament annually. The Securities Commission's many regulatory functions include:

- Regulating all matters relating to securities and futures contracts;
- Regulating the take-over and mergers of companies;
- Regulating all matters relating to unit trust schemes;
- Licensing and supervising all licensed persons;
- Supervising exchanges, clearing houses, and central depositories;
- Encouraging self-regulation; and
- Ensuring proper conduct of market institutions and licensed persons.

The relevant legislation for which the Securities Commission is guardian includes the Securities Industry Act, the Securities (Central Depositories) Act, and the Securities

Commission Act. The Securities Commission has all powers under the legislation to deal with matters concerning 'securities laws'. 'Securities' is defined widely under section 2 of the Securities Commission Act as:

> . . . debentures, stocks, and shares in a public company or corporation, or bonds of any government or of any body, corporate or unincorporate, and includes any right or option in respect thereof and any interest in unit trust schemes.

The Securities Commission's ultimate responsibility is to protect the investor. Apart from discharging its regulatory functions, the Securities Commission also is obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia. The functions of the Securities Commission under section 15(1) of the Securities Commission Act are to:

- Advise the Minister on all matters relating to the securities and futures industries;
- Regulate all matters relating to securities and futures contracts;
- Ensure that the provisions of the securities laws are complied with;
- Regulate the take-overs and mergers of companies;
- Regulate all matters relating to unit trust schemes;
- Be responsible for supervising and monitoring the activities of any exchange, clearing house, or central depository;
- Take all reasonable measures to maintain the confidence of investors in the securities and futures markets by ensuring adequate protection for such investors;
- Promote and encourage proper conduct among members of the exchanges, clearing houses, central depositories, and all licensed persons;
- Suppress illegal, dishonourable, and improper practices in dealings in securities and trading in futures contracts, and provide investment advice or other services relating to securities or futures contracts;
- Consider and make recommendations for the reform of the law relating to securities and futures contracts;
- Encourage and promote the development of securities and futures markets in Malaysia, including research and training in connection thereto;
- Encourage and promote self-regulation by professional associations or market bodies in the securities and futures industries;
- License and supervise all licensed persons as may be provided for under any securities law; and
- Promote and maintain the integrity of all licensed persons in the securities and futures industries.

The Securities Commission's mission statement is to promote and maintain fair, efficient, secure, and transparent securities and futures markets and to facilitate the orderly development of an innovative and competitive capital market.

Kuala Lumpur Stock Exchange

The Kuala Lumpur Stock Exchange is a public company limited by guarantee. The Kuala Lumpur Stock Exchange is regulated by the Securities Industries Act, which itself directly comes within the purview of the Ministry of Finance in Malaysia.

Pursuant to section 9B of the Securities Industries Act, the Kuala Lumpur Stock Exchange has a statutory duty to 'ensure, so far as may be reasonably practicable, an orderly and fair market in the securities that are traded through its facilities'. Its statutory duties include:

- Acting in the interest of the public;
- Ensuring that its interests do not conflict with the public interest;
- Ensuring that its members whose shares also are listed on stock exchanges comply with the rules of the relevant stock exchanges;
- Notifying the Securities Commission if it becomes aware of any irregularity of any of its members in meeting its obligations in respect of its business of dealing in securities or breaches of any rules of the exchanges;
- Providing and maintaining, to the satisfaction of the Securities Commission, an adequate and properly equipped premises for the conduct of its business;
- Ensuring that it has competent personnel for the conduct of its business; and
- Providing automated systems with adequate capacity, security arrangements, and facilities to meet emergencies.

As a public company, its membership is determined by the memorandum and articles of association. The Kuala Lumpur Stock Exchange has prescribed rules, as set out in its articles of association, which include certain disciplinary provisions allowing it to punish errant members through suspension and fine or other disciplinary actions.

Membership in the Kuala Lumpur Stock Exchange is limited to a maximum of 200 natural persons and 50 corporations. Corporate members must have shareholders funds in excess of RM 100 million and hold at least 51 per cent equity of a stockbroking company. Foreign nationals or stockbroking houses may be admitted as members of the Kuala Lumpur Stock Exchange only with the approval of the Minister of Finance.

Registrar of Companies

The Registrar of Companies administers the Companies Act. The principal functions of the Registrar of Companies in securities regulations are mainly in the following areas:

- Regulation of fund-raising activities from the public;
- Allotment of shares to the public;
- Regulation of 'participatory interest', which loosely means rights or interest which allows its holders certain return on investments;
- Compliance with accounting and financial matters; and
- Investigation into affairs of companies.

The chief functions of the Registrar of Companies in securities matters are normally restricted to compliance with prospectus requirements where shares or participatory interests are offered to public or when funds are elicited from the public.

Foreign Investment Committee

In General

The Foreign Investment Committee is a committee whose members are drawn from senior levels of government departments, such as the Special Economic adviser who acts as chairman. Other committee members include the Secretary-General of the Treasury, the Governor of the Central Bank, the Secretary-General of the Ministry of International Trade and Industry, the Chairman of the Malaysian Industrial Development Authority, and the Registrar of Companies. The secretariat to the committee is established in the Economic Planning Unit of the Prime Minister's Department.

The Foreign Investment Committee issued guidelines for the regulation of acquisition of assets, mergers, and take-overs of companies and businesses commonly known as 'the Foreign Investment Committee Guidelines' on 20 February 1974, following the introduction of the then-New Economic Policy of Malaysia. Malaysia suffered setbacks with racial disturbances and economic woes stemming from the unequal distribution of the economic pie between the Malays (also generally known by the local term 'Bumiputra', which literally means 'son of the soil') and non-Malays.

This also was contributed to by the widening economic gap between foreigners and Malaysians. The government of the day adopted the New Economic Policy with the emphasis on eradicating poverty and restructuring society so as to correct racial economic imbalance.

The New Economic Policy has since lapsed, and the government has indicated that the target for ownership by Malays has improved substantially but has not yet reached its intended goal. The New Economic Policy has now been substituted by the National Economic Policy, where much of the same emphasis of the New Economic Policy remains in place. Hence, the implementation of the Foreign Investment Committee Guidelines continues to be an important consideration for foreign investment in Malaysia.

In general, the Foreign Investment Committee Guidelines only cover six categories of investments, which are:

- Proposed acquisition by foreign interests of any substantial fixed assets in Malaysia;
- Proposed acquisition of assets or any interests, mergers, and take-overs of companies and businesses in Malaysia by any means, which will result in ownership or control passing to foreign interests;
- Proposed acquisition of 15 per cent or more of the voting power by any one foreign interest or associated group, or by foreign interests in the aggregate of 30 per cent or more of the voting power of a Malaysian company and business;
- Control of Malaysian companies and businesses through any form of joint venture agreement, management agreement, and technical assistance agreement, or other agreements;

- Merger or take-over of any company or business in Malaysia whether by Malaysian or foreign interests; and
- Other proposed acquisition of assets or interests exceeding in value of RM 5 million whether by Malaysian or foreign interests.

The Foreign Investment Committee has, since its establishment, issued several clarification notes regarding detailed application procedures. A company that is in the manufacturing sector may apply for a manufacturing licence under the Industrial Coordination Act (through the Ministry of International Trade and Industry) if its shareholder funds are in excess of RM 2.5 million and it employs more than 75 workers.

The terms of the manufacturing licence would permit 100 per cent foreign ownership if more than 80 per cent of its products were for export. Companies with a manufacturing licence are exempted from applying to the Foreign Investment Committee if they are directly regulated under the Industrial Coordination Act.

In theory, any single foreign interest exceeding 15 per cent, or a combination of foreign interests exceeding 30 per cent in Malaysian-incorporated companies, would require Foreign Investment Committee approval. This would technically apply to all new ventures or start-ups by foreigners. In practice, however, local consultants have invariably advised foreigners to obtain the Foreign Investment Committee approval on a necessity basis as it may be difficult to look for Malay or local partners for start-up companies.

In most instances, a grace period can be obtained from the Foreign Investment Committee to divest the equity of such companies to local partners. Each case will depend on its own merits and the government policy of the day.

Non-Compliance with Foreign Investment Committee Guidelines

The Foreign Investment Committee Guidelines, not being a creature of statute, therefore attract no penal sanctions for non-compliance. In the case of *Ho Kok Cheong Sdn Bhd* v *Lim Kay Tiong*,[2] Wan Hamzah J dismissed an argument that an agreement that did not comply with the Foreign Investment Committee Guidelines was void and unenforceable as being in contravention of public policy. He held that:

> The [Foreign Investment Committee] Guidelines were issued not pursuant to any power given by law and, in my opinion, they have no force of law but are of advisory character merely. I do not think that non-compliance with the Guidelines can be taken as an act opposed to public policy. The Guidelines reflect the government's political policy, but government's political policy is not public policy.

2 *Ho Kok Cheong Sdn Bhd* v *Lim Kay Tiong* [1979] 1 LNS 29.

In *David Hey* v *New Kok Ann Realty Sdn Bhd*,[3] the Federal Court of Malaysia commented in *dicta* (obviously in reference to Wan Hamzah J's comments in the *Ho Kok Cheong Sdn Bhd* case) that:

> . . . the [Foreign Investment Committee] Guidelines constituted more than a political policy, reflecting as it did an economic policy of which the Court could properly take judicial notice.

In the more recent case of *Thong Foo Ching* v *Shigenori Ono,*[4] the Court of Appeal, Siti Norma Yaakob JCA, held that:

> A reading of the guidelines shows that there is no penalty imposed for non-compliance of any of their provisions. From the very nature of the document itself, and its purpose to eradicate poverty by restructuring the Malaysian society so as to correct any racial economic imbalance, at most I would say the [Foreign Investment Committee] Guidelines impose a moral obligation only on those effected to comply with their provisions. In this respect, I agree with Mr Wong that non-compliance or avoidance of the guidelines cannot render any agreement to be invalid or unenforceable. At most, non-compliance can be used as a means of refusing to exercise a discretion, a purely administrative act, as was done by the directors in the *David Hey* case. On the facts of the appeal before us, I consider that the learned trial judge was correct when she held that avoidance of the guidelines in the manner that was done in this case cannot be held against the respondent as to render the two agreements invalid.

In the *Shigenori Ono* case, the parties have attempted to avoid the Foreign Investment Committee Guidelines by structuring a sale of a real property by breaking up the transaction into a purchase of the real property for a value that is below the Foreign Investment Committee Guidelines requirements and another purchase of a shelf company for the balance sum of the agreed price for the real estate.

Interestingly, the Court of Appeal in the *Shigenori Ono* case went on to hold that the agreements were void as being against public policy because the structuring of the agreements has the effect of evading real property gains tax which the land owner would have to bear and a reduction in the stamp duties which would otherwise have been payable at a higher amount if only one instrument for the purchase of the real property had been effected.

This decision should ring bells of caution for any foreign investors seeking to achieve a tax-advantageous structure to avoid tax. One must always ensure that the structured agreements are not a scheme to evade tax.

Extra-Legal Considerations

Although there are no penal sanctions for non-compliance with the Guidelines, the above cases have indicated that there are some extra-legal consequences that foreigners should

3 *David Hey* v *New Kok Ann Realty Sdn Bhd* [1985] 1 MLJ 167.
4 *Thong Foo Ching* v *Shigenori Ono* [1998] 4 CLJ 674.

be aware of. This could include circumstances whereby the board of directors may refuse to register the transfer of shares that are in contravention of the Foreign Investment Committee Guidelines.

To the extent that the court takes judicial notice of the Foreign Investment Committee Guidelines, the court will not disturb the board's discretion to refuse a transfer if the board chooses to follow the Foreign Investment Committee Guidelines, no matter what the articles of association of the company may say about such matters. This presents a difficult situation to a shareholder who may have acquired beneficial interests in the shares but can never exert its legal interests to have its name registered in the register of members with the company.

Non-compliance with the Foreign Investment Committee Guidelines also may carry with it a certain degree of administrative inconvenience. These include:

- Application for expatriate immigration passes for local companies;[5] and
- Acquisition of real property where a 30 per cent foreign-controlled company is deemed to be a foreigner.[6]

If a company seeks to do business with the local government authorities or government-owned corporations, evidence of local participation is normally set out as tender requirements. If local companies require licensing for its business transactions, the licensing authorities may require, as part of its approving procedure, supporting letters from the Foreign Investment Committee.

In view of the pervasive nature of the Foreign Investment Committee Guidelines, almost all prudent advisers would include into agreements relating to investments in Malaysia that such agreements are conditional on the Foreign Investment Committee approval being obtained within a certain time frame and on terms satisfactory to the investors within the prevailing investment climate. Non-approval by the Foreign Investment Committee would naturally mean that the agreements are not in force and foreign parties should adopt proper exit mechanisms.

Malaysian Central Depository Berhad

The Malaysian Central Depository Berhad is a subsidiary of the Kuala Lumpur Stock Exchange. The Malaysian Central Depository Berhad was established in 1990 to provide efficient central clearing and settlement of securities. The Malaysian Central Depository Berhad is the only authorized central depository permitted under the Securities Industry (Central Depositories) Act 1991 for the operation and maintenance of a Central Depository System in respect of shares, stock bonds, debentures, or other securities of any corporation.

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5 In most instances, an approval letter from the Foreign Investment Committee is required to support such an application for professional expatriate passes.

6 In some states, in addition to government approval, the relevant land offices also may require letters of approval from the Foreign Investment Committee to support an application to effect a transfer of title in relation to real property to the Malaysian company.

The Central Depository System creates a scripless trading environment for the Kuala Lumpur Stock Exchange by making it a legal requirement for trading of shares on the Kuala Lumpur Stock Exchange that all physical share certificates of companies listed on the Kuala Lumpur Stock Exchange are immobilized and housed with the Malaysian Central Depository Berhad. Investors use the Central Depository System for safekeeping of shares and for custodian and pledging services. Stockbroking companies are appointed as Authorized Depository Agents to provide Central Depository System facilities and services to the investing public.

All investors, whether individual or corporate, are required to open Central Depository System accounts with an Authorized Depository Agent if they wish to trade in prescribed securities. Commercial and merchant banks, finance companies, certain government institutional investors, insurance companies, unit trusts, and other institutional investors also participate in the Central Depository System as Authorized Direct Members.

The Central Depository System further interacts with other users such as the issuers, registrars, issuing houses, the Securities Commission, and the Kuala Lumpur Stock Exchange. The first Central Depository System account was opened on 13 November 1992, marking the commencement of the Malaysian Central Depository Berhad's operations.

Kuala Lumpur Options and Financial Futures Exchange

The Kuala Lumpur Options and Financial Futures Exchange is ultimately owned by the Kuala Lumpur Stock Exchange.

The Kuala Lumpur Options and Financial Futures Exchange is permitted to operate a Options and Financial Exchange pursuant to the Futures Industries Act 1993 to trade in equity derivatives.

Ministry of International Trade and Industry

The Industrial Coordination Act of Malaysia regulates the issuance of manufacturing licences. Such licences are required when companies in the manufacturing sector accumulate a shareholders fund in excess of RM 2.5 million and employ more than 75 workers. The Ministry of International Trade and Industry is the authority for the issuance of manufacturing licences.

The manufacturing licences normally contain conditions relating to equity requirements that are in line with the Foreign Investment Committee Guidelines. Export-oriented industries normally enjoy a higher foreign equity content. On the company being listed, such equity conditions will normally not apply. However, as a pre-listing requirement, the securities of the affected company must have a minimum of 30 per cent Bumiputra content.

It would then appear that there are two authorities that will regulate foreign equity conditions, namely, the Foreign Investment Committee and the Ministry of International Trade and Industry, respectively. To avoid a conflict between the equity conditions which the

Foreign Investment Committee and the Ministry of International Trade and Industry may impose, the Foreign Investment Committee issued a clarification note in 1989 that only the Ministry of International Trade and Industry will deal with companies that have manufacturing licences and the Foreign Investment Committee will deal with non-manufacturing companies.

Bank Negara Malaysia

The Bank Negara Malaysia is the Malaysian Central Bank, established pursuant to the Central Bank Act. Bank Negara Malaysia's prior approval must be obtained for dealings in securities affecting financial institutions and insurance companies.

With the onset of the Asian financial crisis in 1997, the Central Bank has assumed a more critical role as the controller of foreign exchange and acts as guardian of the Foreign Exchange Act. When the ringgit came under speculative currency attack, the Malaysian government implemented selective capital controls by declaring all ringgit outside of Malaysia as being without value (if not brought within the country by a fixed grace period), pegging the United States dollar at RM 3.80 and curbing outflow of ringgit unless approval from the Central Bank is obtained.

To a large extent, these capital control procedures have assisted in resolving the financial crisis, but not without heavy criticism and a continuing outcry amidst the changing political profile of the government. Gradually, the capital controls have been relaxed and, for all intents and purposes, the controls exist in name rather than form and currencies are freely repatriable subject to reporting procedures and capital gains levy being imposed.

Foreigners wishing to bring funds into Malaysia will have to open special external accounts in Malaysian banks. The initial funds will be assumed as capital from which any repatriation will be considered a return of the capital. Hence, where the return of capital is higher than the initial funds, there will be a rebutable presumption of capital gains unless accounts holders can prove otherwise.

To discourage short-term speculative money from disrupting the Malaysian economy, a flat rate of 10 per cent on capital gains is levied on any repatriation of profits by foreigners if such funds are moved out of Malaysia within one year of their remittance.

Regulatory Procedures

Trading System

Trading on the Kuala Lumpur Stock Exchange is scripless and fully computerised. The Kuala Lumpur Stock Exchange uses the broker front-end system known as the WinSCORE system. WinSCORE is a real-time information dissemination system, and it comprises two major computer systems, namely:

- SCORE (System for Computerised Order Routing and Execution), which is the central computer engine responsible for the matching of all orders; and

- WinSCORE, the broker front-end trading system, which is responsible for credit control management, order and trade routing, and confirmation.

Before a person can trade in the shares of Kuala Lumpur Stock Exchange listed companies, he will first need to open a trading account with one of the local stockbroking companies. Trading of shares may only be permitted through a licensed dealer or remisier.

With the implementation of the Central Depository System, all shares are immobilized and lodged with the Malaysian Central Depository Sdn Bhd. This creates a scripless trading environment where each beneficial shareholder will maintain his entitlement to the shares which he owns through a Central Depository System account. Any person can open a Central Depository System account with one of the stockbroking companies which acts as the Authorized Depository Agent of the Malaysia Central Depository Sdn Bhd.

A purchase transaction starts off with an order given by a client to his remisier to buy a specified number of shares of a company at a specified price. The client also will need to quote his Central Depository System account number for Central Depository System counters. This order will be keyed by the remisier into the WinSCORE terminal at the stockbroking company. The order is then relayed through the WinSCORE system to the Kuala Lumpur Stock Exchange's central computers.

An order confirmation is immediately routed back to the broking company. The order for the purchase of shares will then be matched automatically by the system with a similar order for the sale of the shares at the same price, assuming that it is matchable in the first place. The price at which an order is matched is determined by the market forces of supply and demand through a process of bids and offers.

The price transacted for a buy order will be either at the same price keyed in, or lower if the seller's price is below the buyer's price. For a sale transaction, the price will be the same or higher if the buyer's order is higher. In other words, in every transaction, a security is sold to the highest bidder and purchased from the lowest offeror.

Once the order has been matched, a trade confirmation is printed out at the broker's office providing details such as the original order number, stock number, price and quantity matched, and the counter-party broking company. The remisier in turn confirms with his client that he has bought the specified number of shares and the price at which they were bought.

A sell order is carried out in the same manner. The broking house will then send out contract notes, for buying and selling, to the clients giving details of the transaction, such as brokerage, stamp duty and clearing fees payable, and the cost of the purchase or proceeds of the sale.

The Central Depository System uses a simple book-entry system to keep track of the movement of shares arising from trades effected on the Kuala Lumpur Stock Exchange, and the Central Depository System account of the purchaser will be credited with the shares he bought and, similarly, the Central Depository System account of the seller will

be debited for a similar quantity of shares. Sellers must have adequate shares in their Central Depository System accounts by 12:30 pm on the fourth day of the trade.

The buying client will be informed by his remisier that the shares have been transferred to his Central Depository System account. However, the buying client cannot further trade in those shares until he has settled the payment due.

Securities Clearing Automated Network Services Sdn Bhd (SCANS) provides clearing services for stockbroking companies. Only domestic contracts of all securities listed by the Exchange are cleared by the Securities Commission. There is no clearing facility for cross-border trades. To facilitate clearing and settlement, the Kuala Lumpur Stock Exchange has established a Fixed Delivery and Settlement System (FDSS).

The FDSS which is adopted by the Kuala Lumpur Stock Exchange is based on a T+5 (transaction date plus five days thereafter) rolling settlement. A fixed rolling settlement system requires that all trades are scheduled for settlement the same number of days after the trade date, which allows trades to settle on all business days of the week. In a T+5 rolling settlement environment, Monday trades are settled by the following Monday, five business days hence; Tuesday's trades are settled by the following Tuesday, and so forth.

A typical transaction for foreign institutional investors would commence with an initiation of a trade by an institutional investor, who can either be a foreign institution or a local institution. If a trade is initiated by a foreign institutional investor, eg, by a foreign fund manager, this can be done either by placing an order with a foreign stockbroker, who will place the order with a local stockbroker, or by placing an order directly with a local stockbroker.

Once an order is executed and matched, the local stockbroker will relay the information to the foreign stockbroker, who will subsequently relay this to the foreign institutional investor. Ensuing this, arrangements shall be made among the parties with regard to the acceptance/delivery of shares and payment under Institutional Settlement Service (ISS).

Shift to Disclosure-Based Regime

The Securities Commission inherited the merit-based regulation regime with its inception in 1993. In 1996, the Securities Commission began a programme to shift to a disclosure-based regulation regime as a basis for the necessary progression of the Malaysian capital market to become more efficient and to develop into a sound and credible market of international standing.

Under the merit-based regulation, the Securities Commission regulates the offering of securities by assessing the investment merits and pricing of the offering. The regulator assumes a paternalistic role in assessing the merit of securities to be issued and interposes itself between those seeking to raise funds and those seeking to invest.

Under the disclosure-based regulation, the onus of assessing the merit of any securities rests with the investors whose money is being put at risk. The investors assess and determine the investment merits of the offering while the Securities Commission regulates the

disclosure of material information. The shift to a disclosure-based regulation regime will take be carried out over three phases, as follows:

- Phase 1, 1996–1999, flexible merit-based regulation with enhanced disclosure, due diligence and corporate governance;
- Phase 2, 1999–2000, hybrid merit-based regulation and disclosure-based regulation, with further emphasis on disclosure enhancement, due diligence, and corporate governance, as well as promotion of accountability and self-regulation; and
- Phase 3, 2001 onwards, full disclosure-based regulation, with high standards of disclosure, due diligence, and corporate governance, as well as exercise of self-regulation and display of responsible conduct.

The Securities Commission is currently in Phase 2 of the shift to disclosure- based regulation. During Phase 1, the most notable change was the flexibility allowed for securities under initial public offerings and rights issues to be priced on a market-driven basis and fixed by companies together with their advisers and underwriters. There is increased responsibility on the companies and their investments advisors in relation to this disclosure-based regulation shift. The measures taken by the Securities Commission to date in the shift to full disclosure-based regulation are:

- Amendments to the Securities Commission Act 1993;
- Amendments to the Securities Industry Act 1983;
- Amendments to the Securities Industry (Central Depositories) Act 1991;
- Introduction of, and subsequent amendments to, the Policies and Guidelines on Issue and Offer of Securities (1995, 1997, and 1999);
- Publication of Guidelines on Due Diligence Practices (1996);
- Introduction of the new Malaysian Code on Take-overs and Mergers (1998);
- Introduction of the Securities Commission (Unit Trust Scheme) Regulations 1996 and the Guidelines on Unit Trust Funds (1997, with Practice Notes in 1998 and 1999);
- Establishment of Malaysian Exchange of Securities Dealing & Automated Quotation (MESDAQ), which operates on full disclosure-based regulation principles (1997);
- Establishment of the Financial Reporting Surveillance and Compliance Department within the Commission with the responsibility of monitoring the financial reporting standards of public listed companies (1998); and
- Release of the Corporate Governance Report by the Finance Committee that includes the Malaysian Code on Corporate Governance (1999).

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. There are only two domestic exchanges, both of which are regulated by the Securities Commission. The first is the Kuala Lumpur Stock Exchange and

the other is MESDAQ. The Kuala Lumpur Stock Exchange maintains two boards, ie, a Main Board and a Second Board.

The Kuala Lumpur Stock Exchange was established in 1973 to provide a central market place for buyers and sellers to transact business in the shares, bonds, and various other securities of Malaysian listed companies. A strong link existed between the Kuala Lumpur Stock Exchange and the Stock Exchange of Singapore at that time as Malaysian-incorporated companies also were listed and traded through the Stock Exchange of Singapore, and *vice versa* for Singapore-incorporated companies.

A significant milestone for the Kuala Lumpur Stock Exchange was achieved in 1990 with the de-listing of Singapore-incorporated companies from the Kuala Lumpur Stock Exchange and *vice versa* for Malaysian companies listed on the Stock Exchange of Singapore. This move heralded the growth of the Kuala Lumpur Stock Exchange as a stock exchange with a truly Malaysian identity.

Thereafter, the Singapore Stock Exchange formed the over-the-counter market for such shares. CLOB International was formed in January 1990, an extension of the Central Limit Order Book system of the Stock Exchange of Singapore. CLOB's role diminished with the introduction of the Central Depository System under the Securities Industries (Central Depositary) Act 1991, which saw a mandatory legal requirement to deposit its physical shares with the Malaysian Central Depositary.

In 1998, the Malaysian government made further changes to the Securities Industries Regulations, whereby shares which are not deposited with the Malaysian Central Depositary will not be recognized by the Kuala Lumpur Stock Exchange. The decision prompted a closure of Malaysian securities that were traded on CLOB. This led to a dispute between the investors on CLOB securities and the Kuala Lumpur Stock Exchange.

Various proposals were tabled to both the Kuala Lumpur Stock Exchange and the Singapore Stock Exchange to resolve the impasse. Finally, a proposal from Effective Capital Sdn Bhd, an initiative from a Malaysian private sector, was recognised by both stock exchanges for a voluntary migration plan for the securities from CLOB to the Central Depositary of Malaysia.

The Malaysian Exchange of Securities Dealings and Automated Quotations Berhad (MESDAQ) is an approved stock exchange in Malaysia established pursuant to section 8(2) of the Securities Industries Act 1983 on 6 October 1997. Its primary function is to cater for technology-based companies and companies with strong growth potential but which do not have a profit track record.

MESDAQ is conceived with the intention of making an important capital market contribution to the development of the Multimedia Super Corridor (a high-technology development area where approved applicants enjoy considerable tax benefits and numerous other incentives and guarantees) as envisaged by the Malaysian Prime Minister, Dato Seri Dr Mahathir. In the longer term, the new market can be the platform to provide a NASDAQ-like market for high-technology companies and small companies with growth potential from within the Asian region.

MESDAQ is independent of the Kuala Lumpur Stock Exchange. It is a wholly member-owned, not-for-profit body. MESDAQ also is a Self-Regulatory Organization (SRO) with statutory responsibilities to regulate its members and to efficiently run the market. In carrying out its duties as an SRO, it must:

- Conduct examinations to ensure minimum standards of professionalism among intermediaries in the market;
- Enforce disciplinary procedures among members to promote high standards of commercial conduct and trade practices;
- Conduct arbitration procedures to settle disputes and controversies;
- Make surveillance of market activities through the use of automated systems; and
- Ensure that market makers fulfil their obligations at all times and, above all, promote investor trust and confidence in the market by way of public disclosure programmes and efficient and transparent information dissemination systems.

The Securities Commission, nevertheless, oversees the operations of the MESDAQ, and it ensures that MESDAQ adopts best practices and enforces compliance of its own rules in accordance with the securities laws of the country.

The criteria for admissions into these boards are governed by the rules of the Kuala Lumpur Stock Exchange and the Guidelines of the Securities Commission.

Kuala Lumpur Stock Exchange Admission Criteria. The requirements for listing of and quotation of securities on the Kuala Lumpur Stock Exchange are governed by the Policies and Guidelines for Offer and Issue of Securities ('the Securities Commission Guidelines'), issued by the Securities Commission, and the Kuala Lumpur Stock Exchange Listing Requirements.

The Securities Commission Guidelines set out four methods by which a public company may list and quote its shares, either for a going concern or for a successor of a going concern. They are:

- An offer to the public for subscription by or on behalf of an issuer of its own securities;
- An offer to the public by or on behalf of holders or allottees of securities already in issue or agreed to be subscribed;
- The obtaining of subscription for or the sale of securities by an issuer primarily from or to persons selected by the issuer; and
- An offer of a portion of the securities by way of tender subject to a minimum price being prescribed.

In assessing the suitability for listing, the Securities Commission will consider quantitative and qualitative factors. Quantitative requirements reflect the minimum requirements needed to qualify for consideration for listing whereas qualitative factors would reflect the quality of the earnings.

Where a group of companies is seeking listing on the Kuala Lumpur Stock Exchange, at least one company within the group should be able to fulfil the profit track record requirements. If no company qualifies, listing could be based on the strength of the group's *pro forma* accounts, provided that all companies within the group:

- Are involved in the same or complementary business activities;
- Have common directors; and
- Have common shareholders with controlling shareholding on a collective basis.

A group of Bumiputera-controlled companies applying for listing based on the strength of the group's *pro forma* accounts would only need comply with the criterion that the companies should be involved in the same or complementary business activities, and not with the other two criteria that there must be common directors and common controlling shareholders. Such a Bumiputera group of companies, to qualify for the flexibilities given, should fulfil the following conditions:

- The group must have a genuine pooling arrangement;
- The company which is the single largest contributor, on an average basis for the past three full financial years, to profits within the *pro forma* group should have been incorporated and have been operating in the same or complementary business for at least five full financial years prior to making submission to the Securities Commission;
- Each company to be pooled together must have been a Bumiputera- controlled company under the control of the same Bumiputera shareholders with controlling shareholding for at least three full financial years prior to making submission to the Securities Commission (or throughout the life of the company if the company has been incorporated for less than three financial years); and
- The company used as the listing vehicle must, on and subsequent to listing, be a Bumiputera-controlled company.

A company is classified as a Bumiputera-controlled company if either one of the following two criteria is satisfied:

- More than 50 per cent of its equity is owned by Bumiputera shareholders; or
- At least 35 per cent of its equity is owned by an identifiable Bumiputera shareholder and (a) there is no other non-Bumiputera group holding more than 10 per cent of the voting power of the company or, in aggregate, the identifiable non-Bumiputera groups should not own more than 24 per cent of the voting power of the company, (b) the shareholding of the Bumiputera group is not associated directly or indirectly with any non-Bumiputera group; (c) the Bumiputera group is the rightful owner and each Bumiputera party is capable of exercising the voting power attached to his shareholding free of any influence, (d) the chairman, chief executive officer/managing director, and at least 51 per cent of the company's board members are Bumiputera individuals, and (e) at least 51 per cent of the management, professional, and supervisory staff comprise Bumiputera individuals.

The company seeking listing should generally be in a position to sustain its after-tax profit at a reasonable level to support its enlarged share-capital size in the future financial years. The company must be in a healthy financial position with no shortfall in working capital. All financial ratios are expected to be in line with, if not better than, those prevailing in the industry concerned.

Prior to listing, all debts owing to the applicant company by its directors and other companies controlled by the directors and substantial shareholders (with the exception of the applicant company's subsidiary or subsidiaries) must have been settled. The company is encouraged to pay a reasonable rate of dividend for the financial year following listing.

The net tangible assets per share (net of listing expenses), which should exclude any surplus arising from the revaluation of plant, machinery, or equipment, on flotation, may not be less than the par value of the share.

In the case of acquisition by a newly incorporated or dormant holding company of one or more acquiree companies where the holding company is used as the listing vehicle, the company seeking flotation is required to retain a certain level of reserves equivalent to the amount needed to be maintained in the acquiree company's/companies' reserves.

In this case, the holding company would have to restore the net tangible asset value by the equivalent amount of reserves the acquiree company would otherwise need to retain. The retention of reserves could be effected through a share premium account by way of an upward revision of the price of the rights issue shares or consideration shares to be issued for acquisitions (if any). 'Reserves' for the above purpose comprise retained profits and share premium only.

Where the applicant company is a newly incorporated or dormant company which is to be the investment-holding company under a rationalisation exercise prior to listing, the purchase consideration for the acquisition of those companies by the investment-holding company shall generally be based on the net tangible assets of the acquiree companies, subject to the retention of reserves above.

Where the acquirer company is in operation and has its own track record, the shares of the acquirer company may be valued based on the earnings method. The shares of the acquiree company also may be valued based on the earnings method, provided that the acquiree company is in operation and has its own track record.

The Securities Commission places great emphasis on the quality of the companies going for listing. These qualitative factors indicate strengths of the company and include the following factors:

- Business dynamics — Quality management, diversity of sources of supply or markets, skilled workforce, low staff turnover, technological edge, efficient operations and production processes, capabilities in research and development, capabilities to diversity into synergistic activities, and existence of long-term contracts;
- Competition dynamics — Good quality and range of products or services, focused target market and promotional activities, effective marketing and distribution channels, sizeable market share and good market ranking, competitive pricing, and ability to withstand an economic downturn; and

- Industry dynamics — Inelastic and unsaturated demand, satisfactory market size, stable industry, profitable industry, encouraging past and future growth trends and prospects, high barriers to entry and exit, and minimal threat of substitute products or services.

The company seeking listing or the qualifying company, as the case may be, must have a fully operational business which is independent and autonomous. Generally, the principal or sole asset of the company seeking listing should not be an investment in another listed company.

The company seeking listing or the qualifying company, as the case may be, should have had continuity of substantially the same management for at least three full financial years prior to making submission to the Securities Commission. In determining whether or not this requirement has been met, the Securities Commission will have to be satisfied that, throughout the relevant period:

- The current executive directors have had direct management responsibilities for, and played a significant role in, the company's core business;
- The senior management of the company has not changed materially; and
- The company has been under the control of the same shareholders with controlling shareholding.

Where this requirement has not been met, the promoters of the company seeking listing should demonstrate to the Securities Commission the expertise and capability of management in ensuring the effective operation of the company.

No material conflict of interest between the company and its directors, promoters, or substantial shareholders should exist. Where a company has, or is likely to have, a direct or indirect relationship with a substantial shareholder or a shareholder who has influence on the management of the company or who has an interest in a business which competes, or is likely to compete, with the company's business, which relationship could result in a conflict of interest between the company's obligations towards that shareholder and its duties to the general body of shareholders, the Securities Commission may regard the company as unsuitable for listing. As such, the nature, character, and extent of the relationship and conflict of interest must be declared to the Securities Commission.

Any transactions between the company (or its subsidiaries) and any related parties must be based on terms and conditions which are not unfavourable to the company.

A company seeking listing should not be vulnerable to specific factors or events, eg, dependence on a handful of customers. The Securities Commission may regard a company as unsuitable for listing where it is found to be thus vulnerable. The degree of vulnerability of the company must be analysed thoroughly and the analysis should cover business and financial risks involved and the impact on the company, as well as the measures that have been or will be taken to mitigate or minimize the risks.

The company must be shown to be contributing to the overall economic growth of the country and the achievement of government objectives. Such contribution would include

usage of the country's primary commodities, employment and training of local management and workforce, involvement in value-added activities and provision of linkages to other sectors of the economy and catalyst for growth in other sectors.

Changes in accounting policies merely for the purpose of meeting the profit track record requirement or projecting a higher profit to inflate the price of securities under a public offering would normally not be allowed except where such changes are made in accordance with the reasons as stipulated in the approved accounting standards. The Securities Commission may regard a company resorting to such ploys as unsuitable for listing.

The listing of a holding company will generally not be allowed if one or more of its subsidiary or associated companies is already listed on a stock exchange and these already-listed companies collectively account for 50 per cent or more of the holding company's consolidated after-tax profits and/or net tangible assets in respect of each of the past three full financial years or five full financial years, as the case may be. Listing of a holding company may be considered if the following conditions are satisfied:

- The holding company should have its own autonomous business and should on its own (without its listed subsidiary/associated companies) meet the Securities Commission's requirements for listing; and
- The after-tax profits and/or net tangible assets of its unlisted subsidiary or associated companies account for more than 50 per cent of the consolidated after-tax profits and/or net tangible assets of the group in respect of each of the past three full financial years or five full financial years, as the case may be.

The listing of subsidiary or associated companies of a listed holding company could be considered under the following circumstances:

- The after-tax profits and/or net tangible assets of the subsidiary/associated company to be listed should not account for more than 50 per cent, respectively, of the consolidated after-tax profits and/or net tangible assets of the group in respect of each of the past three full financial years or five full financial years, as the case may be, or, where the company was acquired by the listed holding company for a period which is shorter than three full financial years or five full financial years, as the case may be, each of the years in which the company becomes a subsidiary or associated company;
- The listed holding company (excluding the subsidiary or associated company to be listed and existing listed subsidiary or associated companies) should have its own autonomous business and should on its own meet the Securities Commission's requirements for listing as if it were a new company seeking listing;
- The applicant subsidiary or associated company should be involved in a particular business of its own (with profits able to meet the Securities Commission's criteria for listing with respect to profit track record and future profit performance);
- The relationship between the subsidiary or associated company seeking listing and the other companies within the group, including the holding company, should not give rise to intra-group competition or conflict of interest situation; and

- The subsidiary or associated company to be listed should demonstrate that it is not overly dependent on the other companies within the group, including the holding company, in terms of its operations, including purchases and sales of goods, management, and management policies and finance.

The Securities Commission will not entertain adjustments made to past accounts for the purpose of meeting chain-listing requirements (such as adjustments to expenses, even if the expenses are to be actually reimbursed in the future). In this regard, the Securities Commission does not want to encourage the practice of making good a past shortfall by actual injection of cash in the future.

Firm underwriting arrangements must be in place before the offering of securities is made to the public. In this regard, the underwriting arrangements should be made for the securities, other than those securities in respect of which allocations have been made to certain parties, such as Bumiputera investors, directors, and employees, or for which certain shareholders have given written irrevocable undertakings to subscribe.

In addition, the corporate adviser making the application should be the managing underwriter for the issue and be prepared to be the sole underwriter in the event that the other co-underwriters are not able to underwrite. The full list of underwriters, together with their respective commitments, must be submitted by the adviser to the Securities Commission for its records, and, should there be any subsequent changes, the Securities Commission should be informed immediately.

A moratorium will be imposed on the disposal of shares held by the promoters in Main Board applicant companies involved in property development, construction, services, or specialized activities, and those in all Second Board applicant companies, whereby:

- The affected promoters will not be allowed to sell, transfer, or assign their shareholdings amounting to 45 per cent of the nominal issued and paid-up capital for one year from the date of admission of the company to either the Main Board or Second Board;[7] and
- In the case where the affected promoter is a private holding company, every shareholder of the private holding company (if an individual) or ultimate individual shareholder (if the shareholder of the private holding company is another private holding company) must give an undertaking that he/she will not sell, transfer or assign his shareholding in the related private holding company for the period as stipulated above.

A company listed on the Second Board could, subject to approval of the Securities Commission, be considered for transfer to the Main Board provided that the company has been listed for at least three years and meets the requirements of listing on the Main Board pertaining to issued and paid-up capital, shareholding spread and historical and future profit performance.

7 Thereafter, such promoters are allowed to sell, transfer, or assign only up to a maximum of one-third per annum (on a straight-line basis) of their respective shareholdings under moratorium.

A company listed on the Second Board which has been involved in reverse take-over/back-door listing exercises could only be allowed for transfer to the Main Board on the new injected assets, businesses or interests meeting the profit track record requirement of the Main Board or on the original core asset and/or business of the company meeting the normal requirements for transfer to the Main Board. Exceptions could, however, be given to those cases involving infrastructure projects and other government privatised projects.

MESDAQ Admission Criteria. MESDAQ is subject to all existing securities laws in Malaysia. In addition, the Ministry of Finance may prescribe new regulations which are peculiar to the MESDAQ market. The MESDAQ market operates in a full disclosure-based environment. The Securities Commission does not evaluate the merits or demerits of each proposal submitted by the company in its application for any new issue or offer of securities to the public.

Instead, the Securities Commission, as a regulator, will focus on issues of investor protection by ensuring that all information disclosed is adequate, accurate, and timely. Non-compliance with proper disclosure will attract severe penalties.

The MESDAQ must, by law, act in the public interest and, should there be a conflict between such interest with any interest that is required to be served under the corporation law (eg, interest of shareholders), the interest of the public will prevail. It is a 'higher risk' market because the companies admitted do not have much of an operational history and, in the extreme, may not even have commenced business operations.

The market operates under a full disclosure-based regulatory environment. Market intermediaries, such as brokers, advisers, and underwriters, must assume new roles and responsibilities which are distinct from the main market, the Kuala Lumpur Stock Exchange, as well as higher standards of compliance and disclosure. Market intermediaries are held to higher standards of sales practices and a stringent application of the 'know-your-client-and-product' rule.

Participants in the market are not limited to the existing stockbroking industry. The trading system incorporates elements of both order-driven and quote-driven systems.

The admission criteria is less stringent than that for the Kuala Lumpur Stock Exchange. Only one company is thus far listed, ie, Supercomal Technologies Berhad. However, several applications were being processed by MESDAQ. The Securities Commission approves listing of companies on MESDAQ based on fulfilment of both quantitative and qualitative criteria.

The applicant company should be involved in a single business activity or in a set of substantially related and complementary business activities. MESDAQ has identified priority technology areas covering the design, development, production, manufacturing, and/or assembly of 12 technology-based activities. These areas include:

- Advanced electronics and information technology;
- Automation and flexible manufacturing systems;
- Biotechnology;

- Bioconversion;
- Genetic engineering;
- Healthcare;
- Electro-optics, non-linear optics, and optoelectronics;
- Advanced materials;
- Energy;
- Aerospace;
- Transportation; and
- Emerging technology and services, such as education and training relating to application of smart technologies.

Although emphasis is given to technology companies, this does not exclude non-technology companies with high growth potential from seeking a listing on MESDAQ.

If the company is involved in technology-based activities, it does not require a minimum period of business operations or a profit record. If the company is not involved in technology-based activities, it must have generated operating revenue for at least 12 months at the time of seeking admission. However, no profit track record is required.

The company's minimum issued and paid-up share capital should not be less than RM 2 million. The promoters must hold at least 51 per cent of the issued and paid-up shares of the company on admission to MESDAQ and hold at least 45 per cent of the issued paid-up shares of the company for one year after the company's admission to MESDAQ.

MESDAQ places great emphasis on the following qualitative elements:

- Strength and integrity of the promoters and management;
- Business model and prospects;
- Research and development capabilities;
- Conflict of interests; and
- National policy.

There is a strong emphasis that companies seeking MESDAQ listing must adhere to the spirit of national interest. The applicant company should comply with the National Policy as outlined in the MESDAQ Listing Rules as follows:

- Location of assets — The company must have more than 50 per cent of its assets and operations situated in Malaysia at the time of admission to MESDAQ. This means either more than 50 per cent of the total assets of the company is situated in Malaysia based on the latest audited accounts or revenue of the company from operations in Malaysia should account for more than 50 per cent of its total revenue based on the latest audited accounts.
- Utilization of proceeds — The company must use at least 70 per cent of the funds raised in the initial public offering in Malaysia and have a definite plan and time frame to use the funds raised.

- National Development Policy — Unless exempted by the relevant governmental authorities, the company must comply with the National Development Policy, as follows: (a) if it has a profit record of three consecutive years with an aggregate after-tax profit of a minimum of RM 6 million on admission to MESDAQ, the company must have a minimum of 30 per cent Bumiputera equity participation, and (b) if the company does not have the profit record as stated above at the time of admission, the company must give a written undertaking in the application to fully comply with the National Development Policy requirement within five years after admission, or within one year after it has achieved the profit record, whichever is earlier.

The operational framework of MESDAQ is different from the Kuala Lumpur Stock Exchange. In a new market like MESDAQ, it is anticipated that confidence in the market will be low unless the secondary market for the shares is active. Market intermediaries have been introduced with the aim of ensuring that only quality companies are quoted and that the secondary market will have some form of liquidity.

MESDAQ has prescribed rules for each market intermediary and, generally, all members of the market brokers may, in addition to their dealing functions, be allowed to assume one or more of the following roles subject to suitability criteria, which include, among others, capitalisation, financial health, and experience and expertise of their employees. Brokers who assume more than one role will have to maintain appropriate 'Chinese Wall' procedures within the company to prevent the flow of classified information between the dealers, advisers and underwriters, sponsors, and market makers. The rules may be summarised as follows:

- Advisers and underwriters — All potential issuers will have to seek the services of an adviser who also will act as an underwriter. The adviser is responsible for ensuring that all admission criteria and disclosure requirements have been complied with in an initial public offer application, including coordination of the due diligence exercise and the lodgement of applications and prospectuses. In performing its duties, the adviser will have to undertake extensive due diligence examinations. There are severe penalties for failure to provide proper disclosure or deliberate withholding of material information. The adviser is expected to undertake firm commitments. The adviser will only make such firm commitments when he is certain that the offering is of a quality that he can easily sell to investors at a premium. Therefore, suitability judgements on the prospects of the issuer will, in a sense, be made by the adviser when he decides to bring the company to the market. To ensure that the adviser has a continuing responsibility to the clients to whom he will sell the shares, the adviser is required to provide updates and due diligence information associated with the offering for at least one year after the initial public offer is completed.
- Sponsor — All companies quoted on MESDAQ are required to secure and maintain the services of a sponsor for at least five years after the listing. A sponsor's responsibilities include promoting the company to investors by providing research materials, ensuring that the company complies with market rules and on-going disclosure requirements, and acting as the point of contact between the company and the investor and the

company and MESDAQ. A company without a sponsor during the obligatory period will have to find a replacement within a specified time period, failing which the trading of the company's shares will be suspended and subsequently not allowed to remain quoted on MESDAQ.

- Market maker — Each company listed on MESDAQ must appoint a minimum number of designated market makers for its securities. The designated market makers are required to ensure that there are continuous markets in its securities. A market maker must provide continuous two-way quotes in counter for which he has been designated to make markets. These quotes must be for a minimum total order of two board lots each side and must be within the maximum spread prescribed by MESDAQ.

Transborder Electronic Trading Systems

The Securities Commission is a member of an international Task Force on cross-border securities settlement. The Task Force is a joint initiative of the Technical Committee of the International Organisation of Securities Commissions (IOSCO) and the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements.

The Securities Commission is the only emerging market securities regulator on the Task Force. The latest IOSCO-CPSS Task Force will issue recommendations for the design, operation, and oversight of securities settlement systems, covering both individual systems and the cross-border linkages between them. It also will promote the implementation of measures that can reduce risks, increase efficiency, and provide adequate safeguards for investors.

With the rapid growth in the volume of crossborder securities transactions, many trading systems are in a process of international integration or providing direct access on a crossborder basis to market participants. Settlement systems have much significance in facilitating the minimization of risks for the clearance and settlement of securities transactions, and thereby enhancing the stability of the domestic and international financial system.

Off-Market Transactions

Off-market transactions are defined as 'direct business transactions' in accordance with the Kuala Lumpur Stock Exchange rules. Direct business transactions are permitted only within a price variance of 15 per cent of the volume-weighted average price of the securities of the preceding trading day or the last trading day in which trades were conducted.

Where securities are first traded and where information of volume-weighted average price is not available (such as suspended counters resume trading on first day of uplifting of suspension; or where securities from an initial public offer are first traded; or where securities are first traded on an ex-entitlement basis or after a capital distribution or subdivision or consolidation or reclassification or substitution), direct business transactions are not permitted until the volume-weighted average price is established.

In the event direct business transaction should be effected outside of the 15 per cent price variance of the volume-weighted average price, prior notification to the Kuala Lumpur Stock Exchange of at least 10 trading days must be given before those transactions could be effected. The form of notification is by way of a statutory declaration supported by relevant documents specifying:

- Details of the buyer and seller;
- Number of shares involved and price;
- Basis on which the price was agreed;
- Specific reason for the transaction;
- Proposed date of the intended transaction; and
- Details of compliance with the Malaysian Code of Take-over and Mergers 1998 or any other directive as may be applicable to the transaction.

All statutory declarations carry the penalty of perjury if information contained therein is not correct. The Kuala Lumpur Stock Exchange may issue specific directions on the parties to adhere to the price range of 15 per cent of the volume-weighted average price. If the Kuala Lumpur Stock Exchange does not reply by then, parties are free to carry out the direct business transaction.

Parties in breach of the direct business transaction may be levied with a penalty to pay for the difference between the aggregate permissible value and the aggregate transacted value of the direct business transaction. Direct business transactions are not permissible for suspended counters.

Securities

National Treatment and Reciprocity

It is the government policy to favour Malaysian interest over foreigners and Bumiputra interest over non-Bumiputra interests in line with the National Economic Policy.

As a general trend, foreign interests at the time of listing would generally be limited to 30 per cent, and approval from the Foreign Investment Committee would be required if foreign interests exceed that amount.

Issuer Requirements

Much of what is seen of the Foreign Investment Committee requirements stems from the governmental policy to eradicate poverty and to structure a more balanced economic spread between the various races in Malaysia; in particular, there is an emphasis to elevate the economic strength of the Bumiputras. To this end, most listing requirements of companies in Malaysia would require at least a 70 per cent allocation to Malaysian interests of which at least 30 per cent allocation of shares must be to eligible Bumiputras.

Based on general Foreign Investment Committee policy, foreigners are generally permitted to hold the balance 30 per cent at the point of listing. In many cases, foreigners can

apply for higher percentages of shareholding, but each case will be considered on its own merits and justified with economic arguments as to why there could not be an adherence to the general policies of the Foreign Investment Committee.

Securities Requirements

There are no restrictions on the types of securities a foreign interest can purchase subject only to the rules of the Foreign Investment Committee as mentioned earlier. However, acquisitions of foreign securities and assets by a Malaysian company pose different risks from those associated with acquisitions of domestic securities and assets.

Malaysian public companies are required to seek the Securities Commission's approval in purchasing foreign securities or assets to ensure that only foreign securities and assets which are of quality and fairly valued are acquired and that the shareholders of the Malaysian companies and the investing public at large are appropriately and adequately informed of the details of and risks involved in such acquisitions.

Cash acquisitions of substantial foreign securities and assets[8] require the approval of the public company's shareholders. A public company should not raise funds through the issue of securities for the purpose of refinancing borrowings utilised for cash acquisitions within a period of two years from the completion date of the acquisitions, unless such acquisitions have been referred to and considered by the Securities Commission.

Additional approvals from the Foreign Investment Committee, where applicable, must be sought in respect of the resultant foreign equity ownership of the acquirer company, and the approval of Bank Negara Malaysia, where applicable, must be sought in respect of the remittance and repatriation of funds.

Prospectus Requirements

In General. All public offerings must be supported by an approved prospectus which is to be lodged with the Registry of Companies. The contents of the prospectus are normally incorporated into the submission to the Securities Commission pursuant to section 32 of the Securities Commission Act prior to it being approved by the Registrar of Companies.

The accuracy and completeness of the prospectus cannot be undermined in view of section 32B the Securities Commission Act where the applicant and its advisers would all be guilty of an offence which carries a maximum RM 3 million fine or 10 years' imprisonment, or both, if the contents are inaccurate or there are material omissions. A prospectus should have a summary fact sheet which summarises all salient features of the offering, such as the following:

- Ownership and management of the company;
- Corporate information of the company;

8 'Substantial' relates to a situation where the purchase consideration is more than 25 per cent of the public company's net assets.

- Financial information of the company;
- Business and financial risks of the company and the industry; and
- Prospects of the company and the industry.

A qualifying statement must be included in the prospectus disclosing that the approval of the Securities Commission shall not be taken to indicate that the Securities Commission recommends the proposal, and that investors should rely on their own evaluation to assess the merits and risks of any investment.

A company approved for listing and quotation on the Main Board is required to publish in full its prospectus and application forms in a widely circulated Bahasa Malaysia newspaper and English newspaper. A company approved for listing and quotation on the Second Board, although not required to advertise the full prospectus in a newspaper, is nevertheless required to publish an advertisement of a summary of the prospectus in a widely circulated Bahasa Malaysia newspaper and English newspaper. The company is expected to make available to the public a reasonable number of prospectuses and application forms commensurate with the size of the offering.

Qualification in the Prospectus. The prospectus for a public offering should state prominently that no application has been made by the company for the listing of and quotation for its securities on a stock exchange.

A qualifying statement should be included in the prospectus for the public offering disclosing that the approval of the Securities Commission shall not be taken to indicate that the Securities Commission recommends the proposal and that the listing of and quotation for the securities of the company will only be granted on application by the company and after the Securities Commission has been fully satisfied that the company has met all the criteria as set out in the Securities Commission Guidelines.

Primary Offers of Securities Via the Internet. Arising from numerous queries from offerors or potential offerors who are based outside of Malaysia about the possibility of their offer of securities via the Internet falling within the ambit of Malaysian securities laws, the Securities Commission has issued a statement on 18 August 1999 to clarify the matter.

The Securities Commission is of the view that an offering of securities on the Internet that is accessible within Malaysia is an offer that falls within the provisions of section 32 of the Securities Industry Act. Hence, the approval of the Securities Commission must first be sought if the offer is accessible within Malaysia or if acceptances from within Malaysia have not been expressly excluded. However, foreigners can structure their offering to exclude the operation of section 32 by incorporating the following measures:

- Not publishing the offer or invitation in websites that are frequently visited by, or draws the attention of, a person in Malaysia, eg, offering on websites that have '.my' in their address or that are offering content relevant to a person in Malaysia;

- Ensuring that the offering does not contain information specifically relevant to a person in Malaysia, eg, tax rates or prices which are presented in Malaysian currency;
- Designing or taking steps to automatically exclude and/or reject any subscriptions made by a person from Malaysia and to have a monitoring system on applications made by such person, eg, an offeror may programme its subscription system in such a manner to automatically reject any applications for subscription from a person in Malaysia where the telephone, address, and postal addresses indicate that they are from Malaysia;
- Restricting the access of information of the offering so that a person in Malaysia is unable to view documents that are related to the offering; and
- Incorporating a clear jurisdictional disclaimer into the on-line prospectus or offer document, stating that the offer is not intended to be available in Malaysia or to any person in Malaysia or which clearly states at which jurisdictions the offer is targeted in a list that excludes Malaysia.

Foreigners should be advised that the above measures are not exhaustive, and care must be exercised to ensure compliance with section 32 of the Securities Industries Act in view of the heavy penalty involved.

Corporate Governance

In General. While the majority of Malaysia public-listed corporations exhibit high level of good corporate governance, Malaysia has, in the past, seen a fair share of corporate abuses. These generally concerned the lack of transparency in related party transactions and incidences of conflicting decision making by corporate leaders which generally sacrificed corporate interest over their own. Asset shifting, as well as blatant and abusive conflict-of-interest transactions without proper disclosure by directors and coupled with poor financial management by directors, are great contributing factors.

Code of Conduct. In 1998, a high-level committee was established by the Ministry of Finance to look into establishing a framework for corporate governance and setting best practices for the industry. The committee has submitted a report on this issue and put up a suggested Code of Conduct in respect of corporate governance. Set out as follows are extracts of the report, which has been adopted by the private sector.

Corporate governance has been defined in the report to mean:

> . . . the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long term shareholder value, while taking into account the interests of other stakeholders.

The committee has suggested a Code of Corporate Governance as an initiative of the private sector to lead a review and establish reforms of standards of corporate governance at a micro level. It is based on the belief that, in some aspects of corporate regulation,

self-regulation is preferable and the standards developed by those involved may be more acceptable and thus more enduring. Additionally, it allows for a more constructive and flexible response to raise standards in corporate governance, as opposed to the more black-and-white response engendered by statute or regulation.

A particularly important feature of the Code of Corporate Governance is the aspirational and evolutionary way in which codes influence the expectations of society that are eventually reflected in the law. The attention generated on corporate governance issues has already had an impact on evolving judicial interpretations of directors' duties internationally.

The recommendations set out in the Code are premised on a prescriptive approach to corporate governance. The proposed Code sets out four forms of recommendations, as described below:

- Principles — Part 1 sets out broad principles of good corporate governance for Malaysia. The objective of principles is to allow companies to apply these flexibly and with common sense to the varying circumstances of individual companies. Companies will be required by the Listing Requirements to include in their annual report a narrative statement of how they apply the relevant principles to their particular circumstances. This is to secure sufficient disclosure so that investors and others can assess companies' performance and governance practices and respond in an informed way.
- Best Practices in Corporate Governance — Part 2 sets out best practices for companies. It identifies a set of guidelines or practices intended to assist companies in designing their approach to corporate governance. While compliance with these guidelines is not mandated, companies will be required, as a provision of the Listing Requirements, to explain any circumstances justifying departure from such best practices.
- Exhortations to Other Participants — Part 3 is not addressed to listed companies, but to investors and auditors to enhance their role in corporate governance. These are purely voluntary.
- Explanatory Notes and 'Mere Best Practices' — Part 4 provides explanatory notes to the principles and best practices set out in Parts 1 and 2 and exhortations set out in Part 3. Part 4 also sets out best practices directed at listed companies that do not require companies to explain circumstances justifying departure from best practices, 'mere best practices'.

Due Diligence. In preparing the information to be disclosed to the public, directors of public companies must undertake a due diligence exercise to verify and ensure that the information to be released is accurate and timely.

Due diligence is a process by which inquiries are conducted to ensure that information to be disclosed is true, sufficient, and timely. Due care also must be given to ensure that there is no omission of material information.

Material information is information which would reasonably be expected by rational investors to facilitate their investment decisions. Information that can affect the trading activities and prices of the company's securities must be released immediately. The onus then lies with the investor to consider and weigh the information provided before making decisions.

The Securities Commission has imposed high standards of responsibility on promoters, directors, and advisers in respect of disclosures by amending section 32B of the Securities Commission Act. Any of such parties that submits any application or disclosures to the Securities Commission must ensure that the application or disclosures does not contain any false or misleading information or omission of material information.

A person who contravenes section 32B the Securities Commission Act shall be guilty of an offence and shall on conviction be liable to a fine not exceeding RM 3 million or to imprisonment for a term not exceeding 10 years, or both. A complete statutory defence has been accorded to persons who have carried out a proper due diligence exercise but are still unable at the material time to unveil the inaccuracies or misleading information at the date of submission. Needless to say, parties must immediately inform the Securities Commission of any such inaccuracies or omission as soon as they become aware of the same.

The Securities Commission released a publication on Due Diligence Practices in August 1996 and a further joint publication in 1999 on 'Due Diligence Guidelines on Submission of Proposals to the Securities Commission'. These practices and guidelines are not exhaustive and clients are advised to seek proper legal representation in carrying out any due diligence exercise.

With the emphasis by the Securities Commission on a disclosure-based regime, companies and their directors and promoters are expected to provide full, accurate, and timely disclosure of information to investors, to adhere to good practices of corporate governance, and to have a deeper understanding of the Securities Commission's policies, rules, and regulations. Directors of public companies are expected to discharge their duties with greater integrity and due care, bearing in mind the criminal liabilities imposed on persons convicted of violating the securities laws. Ultimately, they are liable for any breach of the securities laws and regulations.

Registration of Public Offerings

Before a company can officially make offers to the public, it must comply with the Securities Commission Guidelines, the Kuala Lumpur Stock Exchange listing requirements, and the Companies Act requirements of filing the prospectus. The first step towards a public offering is to obtain the approval of the proposal for public offer from the Securities Commission. The Securities Commission serves as the main regulator for the approval of public offerings.

The Securities Commission has statutory power, under section 32 of the Securities Commission Act, to approve any approval for public offerings. In almost all cases, simultaneous applications also may be made in respect of other regulatory authorities, such as:

- The Foreign Investment Committee, for equity ownership structure;
- The Bank Negara Malaysia, where the proposal involves private debt securities or such other instruments regulated by the Central Bank;
- The Director-General of Insurance, where the applicant company is in the insurance business;

- The Ministry of International Trade and Industry, where the applicant company comes within the purview of the Industrial Coordination Act;
- The Economic Planning Unit of the Prime Minister's Department, where it involves a privatisation of a government-owned enterprise; and
- The Ministry of Finance, where it involves financial institutions or stock broking firms.

On the approval of the various relevant authorities and the Securities Commission, a prospectus must be prepared and lodged with the Registrar of Companies before the offer can be made to the public at large.

The form and content of the prospectus must be approved by the Registrar of Companies pursuant to section 37 of the Companies Act. Failure to comply with section 37 will attract a maximum penalty of RM 100,000 or five years' imprisonment or both on conviction. A prospectus is not required if the offer is not made to the public.[9]

Registration of Placements

Chapter 15 of the Securities Commission Guidelines sets out the criteria for private placement. A company undertaking a private placement exercise is required to restore Bumiputera equity participation that may be diluted following the new issue under the private placement within one year of the issue.

Private placements must be approved by the Securities Commission. An application for private placement of new shares should provide for the basis for pricing of the shares, proposed utilisation of proceeds, the company's three-year financial record, underwriting commitment (if any), and identities and background of placees (including ultimate beneficiaries).

Any private placement should not exceed 10 per cent of the issued and paid-up capital of the company before the new issue. The shares placed with any single party should not exceed 20 per cent of total placement. However, there are restrictions as to the placees. The following category of persons are not permitted to be placees of a private issue:

- Directors or existing shareholders of the issuing company or their associates, whether in their own names or through nominees;
- Nominee companies, unless the names of the ultimate beneficiaries are disclosed; or
- Connected clients of the adviser, lead broker, or any distributor.

'Connected client' means:

- A director or substantial shareholder of the adviser, lead broker, or distributor;
- The spouse, parent, child (including adopted child and step-child), brother, sister, or spouse of the child, brother, or sister of any individual above;

9 Companies Act, s 4(6).

- A person in his capacity as trustee of a private or family trust (other than a pension scheme), the beneficiaries of which include any person above;
- A close relative of any person above whose account is managed by the adviser, lead broker, or distributor in pursuance of a discretionary managed portfolio agreement;
- A body corporate which is associated with those indicated above; or
- A company which is a member of the same group of companies as the adviser, lead broker, or distributor.

The Securities Commission also has set out certain requirements to prevent manipulation of private placements. These requirements are that:

- The placee should be independent and not under the control or influence of any of the issuer's directors and substantial shareholders;[10]
- Not more than 20 per cent of the total placement may be allocated to discretionary managed portfolios under the management of the same portfolio manager;
- The adviser, lead broker, or any distributor may not, under normal circumstances, retain any material amount of the shares being placed for his own account;[11]
- The issuer should issue a prospectus in connection with a placement, if deemed necessary;
- The issuer should disclose the purpose of the issue;
- The issue should be priced based on the weighted average market price of the shares for the past five days prior to placement, with a discount of not more than 10 per cent, if deemed appropriate; and
- Where approval of shareholders is sought, the Securities Commission may require that the major or controlling shareholders of the issuer abstain from voting.

In all instances, the maximum foreign interest arising from a private placement, together with any existing shareholding which the foreign interest may have should not exceed 30 per cent except with prior approval of the Foreign Investment Committee (see text, above).

Registration of Secondary Trade

Trading on the Kuala Lumpur Stock Exchange is scripless, and participants in the secondary trading market need to open Central Depository System accounts with authorised depositary agents, namely, the stock broking houses, before they could trade. With the amendments to the section 30 of the Securities Industries Act, no trading for account of undisclosed principals may be allowed except for approved authorised nominees (see text, below).

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10 However, if the Securities Commission is satisfied as to the independence of the placee, a placement may be made to a placee falling within certain categories, on the application of the issuer.

11 Where there is sufficient demand from investors, the adviser, lead broker, or any distributor may not retain more than five per cent of his respective portion of the total placing.

Share movement of account holders can, therefore, be monitored with precision and on a timely basis by the authorities. For the time being, there is not a requirement for registration of any secondary trade except where account holders accumulate more than two per cent of the total issued capital of any company would be deemed to be a substantial shareholder pursuant to section 4(6) of the Companies Act.

Once a person becomes or ceases to be a substantial shareholder, that person is obliged to inform the secretary of the company concerned and the Kuala Lumpur Stock Exchange of this change in status (see text, below).

Periodic Disclosure

In General

It is the responsibility of directors of public companies to ensure that all material information required by the public to make investment decisions is provided accurately, in full, and on a timely basis. In line with the shift from a merit-based system to a disclosure-based system, higher standards have been imposed on the directors and their advisors to make proper, accurate and timely disclosures.

Investors rely on available information when deciding where and when they should invest their money. There is a need for information when new securities are offered in the primary market. There also is a need for information when dealing in securities already traded in the secondary market. Disclosure of information, therefore, benefits investors by facilitating them to make investment decisions.

Companies intending to offer securities to the public are required to fully disclose information about the affairs of the companies and the securities which are being offered, in the offering documents or prospectuses. The Securities Commission Guidelines has set out a set of disclosure rules which are to:

- Make immediate public disclosure of all material information concerning its affairs;
- Release material information to the public in a manner designed to achieve the widest possible dissemination;
- Make periodic announcements of the status of any memorandum of understanding, where such memorandum of understanding has been entered into with another party; and
- Refrain from promotional disclosure activity beyond that necessary to enable the public to make informed investment decisions, in an attempt to influence prices of securities.

Pursuant to the amendments to the Securities Industries Act in 1998, additional powers[12] were conferred on the Securities Commission to require any person to disclose to the

12 Securities Industries Act, s 99A.

Securities Commission, in relation to any dealing in securities, whether or not the dealing was carried out on another person's behalf:

- The name of, and particulars sufficient to identify, the person from whom, through whom, or on whose behalf, the securities were dealt with;
- The nature of the instructions given to that person in relation to the dealing in securities;
- The particulars of the dealing in securities, including (a) particulars of the securities that were dealt with and (b) particulars of consideration given or received for the dealing in securities or any other transaction related to the dealing in securities; and
- Any other information in the possession of the person as the Securities Commission may specify as deemed expedient for the due administration of the Securities Industries Act.

Refusal or failure to comply such request is an offence that attracts a maximum fine of RM 1 million or to imprisonment for a term not exceeding 10 years, or both.

In addition, chief executives and directors of listed corporations are compelled to make disclosures of any interest in securities of the listed corporation or any associated corporation of the listed corporation[13] or any dealings in respect of those securities. Listed corporations also are required to submit to the Securities Commission a copy of their audited annual accounts within two weeks from the date of their annual general meeting and its interim and periodic financial reports immediately after figures are available.

Any change in the registered or business address of the listed corporation and changes to the chief executive or any of the directors of the listed corporation must be notified to the Securities Commission within two weeks of the occurrence of such a change or event.

Foreign Issuers with Primary Admission

The listing of foreign-based companies with substantial Malaysian interests is governed by the Guidelines for the Public Offering of Securities of Foreign-Based Companies with Listing and Quotation on the Kuala Lumpur Stock Exchange, issued by the Securities Commission.

Essentially, these guidelines classify a 'foreign-based company' as a public company incorporated in Malaysia or in a jurisdiction other than Malaysia, having substantial Malaysian interests, and substantial foreign assets and operations, and which seeks a primary listing on the Kuala Lumpur Stock Exchange.

A foreign-based company is considered to have 'substantial Malaysian interests' where, at the point of application to offer securities under the guidelines:

- More than 50 per cent of the issued and paid-up capital of the company is beneficially held by Malaysian shareholders resident in Malaysia having management control; or

13 Securities Industries Act, s 99B.

- The single largest shareholder of the company is Malaysian and resident in Malaysia, having management control, and beneficially holding not less than 33 per cent of the issued and paid-up capital of the company.

A foreign-based company is considered to have 'substantial foreign assets and operations' where at the point of application to offer securities under these guidelines:

- More than 50 per cent of the total tangible assets of the company is situated outside of Malaysia based on the audited accounts for each of the past three financial years;
- The after-tax profits of the company from assets or operations held outside of Malaysia are in excess of 50 per cent of its total after-tax profits based on the latest audited accounts for a full financial year; and
- The aggregate of the after-tax profits of the company from assets or operations held outside of Malaysia for the past three financial years is in excess of 50 per cent of the aggregate of its after-tax profits based on the audited accounts for that period.

Foreign-based companies which are not incorporated in Malaysia may be permitted to list on the Kuala Lumpur Stock Exchange if the Securities Commission is satisfied that the country of incorporation have standards at least equivalent to those in Malaysia with respect to:

- Corporate governance;
- Shareholder and minority interests protection;
- Disclosure standards; and
- Regulation of take-overs and mergers.

Foreign Issuers with Secondary Admission

There is no provision for admission for foreign issuers who already have a primary listing outside of Malaysia for the Kuala Lumpur Stock Exchange.

However, with the introduction of the Guidelines for the Public Offering of Securities of Foreign-Based Companies with Listing and Quotation on the Kuala Lumpur Stock Exchange, the Kuala Lumpur Stock Exchange hopes to attracts foreign issuers to undertake a primary listing in Malaysia. MESDAQ will, however, consider a secondary listing on a case-by-case basis.

Issuers without Ongoing Disclosure Duties

No exceptions are granted to any issuer where the disclosure duties do not apply save where such securities are not issued to the public and are not governed by the Securities Commission Guidelines.

Notwithstanding that, the Securities Commission's prior approval still must be obtained for unlisted securities if those securities fall within the Securities Commission Guidelines.

Privileged 'Foreign Private' Issuers

There is no concept of a privileged foreign private issuer in Malaysia.

ADR Disclosure

Under the Securities Commission Guidelines, full disclosure of all pending litigation of a material nature in which the company or its subsidiaries may be involved in which may affect its income from title to or possession of any of its assets. Material litigation disclosure would also include any arbitration or alternative dispute resolution cases underway which have similar impact on the company or its subsidiaries. There are no definitions as to what would constitute litigation of a 'material nature'.

The common practice in Malaysia is to adopt some yardstick which should give a reasonable disclosure on litigation matters that have some impact on the income of the company or its subsidiaries peculiar to the industry or company concerned. A lower threshold may be applied for a company undergoing financial restructuring than for a going concerned company. To a large extent, material litigation would normally include claims against a company in excess of five per cent of the net tangible asset or 10 per cent of the previous year's audited profits may be a guideline for going concern companies.

Proxy Disclosure

Pursuant to the Securities Industry (Central Depositories) (Amendment) Act 1998, every securities account opened with the Malaysian Central Depositary Sdn Bhd (the Malaysian Central Depository Berhad) must be in the name of the beneficial owner of the deposited securities or in the name of an authorised nominee. Under rule 1.01 of the Malaysian Central Depository Berhad Rules, there are only 11 categories of authorised nominee, which include a custodian bank, a broking house, approved fund managers, and those exempted by the Securities Commission.

Account holders also must declare that they are the beneficial owners of the securities held in their accounts. Failure to make the necessary transfer of the securities into the appropriate securities account or to the authorised nominee may render those securities to be transferred to the Minister of Finance pursuant to section 30 of the Securities Industry (Central Depositories) (Amendment) Act 1998.

It also arose from the amendments to these rules that the Malaysian securities traded on the CLOB exchange in Singapore were rendered 'unauthorised', and agreement has since been reached in March 2000 for a proper migration of those CLOB securities into the Malaysian Central Depository Berhad accounts of the beneficial owners pursuant to a private sector initiative approved by the stock exchanges of Singapore and Malaysia.

Disclosure of Internet and E-Commerce Activities

With the explosion of the Internet and e-commerce activities worldwide, Malaysian public listed companies also have joined in the foray by jumping onto the bandwagon of investing in such technology business. The Malaysian regulators also have cautioned

about the proliferation of dot com companies, and the Prime Minister of Malaysia has voiced out against the danger of bubble dot com companies, many of which may burst in the time to come.

The Kuala Lumpur Stock Exchange has announced a new practice note to take effect in April 2000 requiring public listed companies to make proper disclosure of Internet-related businesses or e-commerce activities. The practice note sets out minimum requirements for announcements of such activities by public listed companies as follows:

- Details of the relevant business model;
- Details of the stage of development and, if already operating, details on the existing level of operations;
- A description of the risks and rewards involved; and
- Details of the technical capability and competence.

After the initial announcement, listed companies will be required to make announcements of the progress of such businesses and activities, including the arrangements, transactions or ventures or proposed arrangements, transactions or ventures in respect thereof on a quarterly basis simultaneously with their quarterly reporting of financial statements, or whenever there is a material development, whichever is earlier.

This obligation continues until operations commence and generate revenue, or the business or activity, including the arrangement, transaction, or venture, in respect thereof is aborted, as the case may be. This will keep investors informed of the progress of such businesses and activities.

Trading Rules

Securities Offerings

Offer. Section 4(1) of the Companies Act defines 'prospectus' as a circular notice advertisement or invitation inviting applications or offers from the public to subscribe for or purchase or offer to the public for subscription or purchase any shares in or debentures of or any units of shares in or units of debentures of a corporation or proposed corporation. There is no definition of what constitutes an offer to the public in the Companies Act.

Offers must be distinguished from an invitation to treat. There would be circumstances in which a company may allot shares to an issuing house which subsequently may make an offer to the public. The first instance will not be classified as an 'offer' in the contractual sense and hence will not attract the prospectus requirements under the Companies Act. Certain statements made by companies will be deemed for purposes of the Companies Act to be prospectuses and, hence, 'an offer' being made to the public. This would include:

- An advertisement offering shares or debentures to the public or calling attention to such an offer;[14]

14 Companies Act, s 40(1).

- A document accompanying an offer for same made by an issuing house with a view to sale to the public;[15] and
- A statement issued in connection with the offer of participatory interests to the public.[16]

Care must, therefore, be made in relation to any announcements which a company makes, including any publication which is being posted on websites of companies.

Public. Any public offering must be approved by the Securities Commission and a prospectus issued and lodged with the Registry of Companies in Malaysia. There is no definition of who constitutes the 'public', but academics have generally accepted that the Australian case of *Corporate Affairs Commission (SA)* v *Australian Central Credit Union*[17] as good guidance in this interpretation. The court stated that:

> The question whether a particular group of persons constitutes a section of the public for the purposes of [section 4(6)] cannot be answered in the abstract. In a case where an offer is made by a stranger and there is no rational connection between the characteristic which sets the members of a group apart and the nature of the offer made to them, the group will, at least ordinarily, constitute a section of the public for the purposes of the offer. If, however, there is some subsisting special relationship between the offeror and members of a group or some rational connection between the common characteristic of members or a group and the offer made to them, the question whether the group constitutes a section of the public for the purposes of the offer will fall to be determined by reference to a variety of factors of which the most important will ordinarily be: the number of persons comprising the group. The subsisting relationship between the offeror and the members of the group, the nature and content of the offer, the significance of any particular characteristic which identifies the members of the group and any connection between that characteristic and the offer.[18]

The Companies Act also provides for a special class of offers (even if they are made to the public) where a prospectus is not required. This amendment was necessitated to promote a more active capital market without unnecessary expenses of prospectus filing. These are when the offerees of the public offering are limited to any of the following classes of persons:

- A prescribed corporation as defined in section 38(7) (which essentially is a banking corporation);
- A registered insurance company;
- A trustee corporation as defined under section 4(1);
- A statutory body established by the states or the federal government;
- An approved pension under section 150 of the Income Tax Act 1967;
- A unit trust scheme, as defined under the Securities Industry Act 1983;

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15 Companies Act, s 43(1).
16 Companies Act, s 90(1).
17 *Corporate Affairs Commission (SA)* v *Australian Central Credit Union* (1985) 10 ACLR 59.
18 *Corporate Affairs Commission (SA)* v *Australian Central Credit Union* (1985) 10 ACLR 59, at p 62.

- A licensed dealer or investment adviser under the Securities Industry Act 1983;
- A corporation incorporated outside Malaysia;
- A public company which is engaged primarily in the making of investment in marketable securities for the purpose of revenue and for profit and not for purpose of exercising control; and
- Any person declared to be an exempt purchaser by the Ministry.[19]

It is poignant to note that a foreign corporation can purchase a Malaysian public offering without the need for prospectus requirements. However, the reverse is not applicable. A foreign corporation having a public offering outside of Malaysia cannot make an offer to the public in Malaysia for subscription of the shares unless a prospectus for the foreign public offering is first approved and lodged with the Registrar of Companies in Malaysia.

Place of Offer. While the traditional form of publication can be easily traced to the source, it is not altogether clear in the case of web publications when it comes to identifying the actual place in which a public offering is made.

Under general principles of company law in Malaysia, no offer can be made to the public in Malaysia without the prospectus first being approved by the Securities Commission and a copy lodged with the Registry of Companies. Hence, a foreign issuer may not be permitted to bring on the shores of Malaysia a prospectus (even if validly issued outside of Malaysia) with a view of soliciting acceptances of offer from the Malaysian public.

Unlisted Securities. All applications for public offerings with no listing and quotation on a stock exchange would be considered by the Securities Commission on the merit of each case.

The general policies and principles adopted by the Securities Commission on public companies intending to undertake offerings of securities to the general public with no listing and quotation on a stock exchange are as follows:

- Promoters and directors — The promoters and directors of the company should have the necessary experience and expertise in the business of the company as well as in managing public companies. As the statutory requirements of the Companies Act 1965 for a public company are more elaborate than for a private company, the Securities Commission is of the view that, unless the directors have the necessary experience and expertise, they should continue to operate their businesses through private companies.
- Purpose of public offer — The proceeds raised from a public offer shall be utilized only for productive purposes. Full details of the utilisation of proceeds should be disclosed. Changes from the declared utilisation should not be made without the prior approval of the Securities Commission.

19 Companies Act, s 47B.

Disclosure of Acquisition of Substantial Holdings

In General. Malaysia has, since 1998, made changes to the Companies Act 1965 reducing the disclosure of substantial holdings from five per cent to two per cent. The burden has therefore increased substantially on parties to make timely disclosure of their change in position whether on becoming or ceasing to be substantial shareholders.

Substantial shareholders also include shareholdings of those persons who normally act in the direction of the beneficial shareholders. This indirect deemed interest is broadly defined in section 122A of the Companies Act, which includes the interest of associates who are under the shareholder's control, his immediate family, and those who customarily would act under the instructions of the shareholders.

A person on crossing or leaving the threshold of a substantial shareholder must notify the company and the Kuala Lumpur Stock Exchange. The company, on receipt of those notices, must inform the Securities Commission and the Kuala Lumpur Stock Exchange for public release. The Kuala Lumpur Stock Exchange maintains a website[20] of listed companies and their company public announcements which the public can assess freely. Notices of substantial shareholding must contain the following:

- Date of change of interest;
- Circumstances giving rise to the change;
- Number of securities acquired or disposed of and the figure as a percentage of the listed public company's issued capital;
- Amount of consideration (excluding brokerage and stamp duties) paid or received; and
- Number of securities held before and after the change and the figure as a percentage of the listed public company's issued capital.

Shareholder Duties. Shareholders' duties are distinct from directors' duties although, in most cases, the directors are nominated and appointed by the shareholders. Shareholders' rights are derived from the memorandum and articles of association, which regulate their relationship with other shareholders as if a contract has existed between themselves by virtue of the terms of the articles of association. From the rights as shareholders to receive notices of general meetings and to vote in the resolutions therein, the general duties as shareholders would therefore be limited to the extent that the exercise of those rights does not impinge on the rights of other fellow shareholders.

The majority shareholders cannot therefore oppress the minority, and general provisions for minority oppression will be available. In many cases of foreign investments, it is usual to structure joint venture companies in line with the National Economic Policy of Malaysia to cater to the local equity participation. Shareholders must be careful not to infringe the provisions of the shareholders' agreement entered into between themselves. The Foreign Investment Committee conditions have certain extra-legal

20 See www.klse.com.my.

impact, and foreign shareholders would be well advised to adhere to these conditions even if they may not have the force of law.

Company Duties. Companies have a separate legal existence from their shareholders. As a going concern, companies operate in a multifaceted environment where their duties to different parties would be different depending on the context of the situation. Generally, a company's interest is normally equated with the shareholder's interest.

Hence, its primary duty would be seen as making profits for itself and enhancing its own financial and economic values. In the true literal sense, a company is but a fiction. It really needs to have directors to run the company's affairs. Its directors and employees are the arms and legs of the company. The company then has duties towards these people in return as its employees to which the terms of the service contract should be adhered to properly.

The company has dealings with its suppliers and customers and the regulatory authorities. In each of these aspects, the company owes a duty to each of these parties largely based on contractual relationships which it forms in the course of its existence. It also has duties towards the society at large in which the company functions, such as the physical environment from which the company may extract its raw materials, the discharges of any affluent in the course of the manufacturing processes, and liability to the public concerning the ultimate products that it sells or distributes, no matter how remote the market may be.

Insider Trading and Fraud

In General

There are various prohibited practices under the Securities Industries Act. These include a substantial revamp and incorporation of 15 additional sections that extended the scope of insider trading pursuant to the Securities Industry (Amendment) Act 1998, which came into force in March 1998. A new section 89 defined 'information' to include:

- Matters of supposition and other matters that are insufficiently definite to warrant their being made known to the public;
- Matters relating to the intentions, or likely intentions, of a person;
- Matters relating to negotiations or proposals with respect to (a) commercial dealings or (b) dealing in securities;
- Information relating to the financial performance of a corporation;
- Information that a person proposes to enter into, or has previously entered into, one or more transactions or agreements in relation to securities or has prepared or proposes to issue a statement relating to such securities; and
- Matters relating to the future.

Section 89E defines an 'insider' to mean a person who:

- Possesses information that is not generally available which, on becoming generally available, a reasonable person would expect to have a material effect on the price or the value of securities; and
- Knows or ought reasonably to know that the information is not generally available.

An insider is prohibited, whether as principal or agent, in respect of any securities to which he has 'information' from doing the following:

- Acquiring or disposing of, or entering into an agreement for, or with a view to the acquisition or disposal, of such securities; or
- Procuring, directly or indirectly, an acquisition or disposal of, or the entering into an agreement for or with a view to the acquisition or disposal of, such securities.

Insider trading is punishable on conviction with a minimum fine of RM 1 million and imprisonment for a term not exceeding 10 years.

The Securities Industry Act provides for certain provisions whereby key officers of listed corporations or partnerships are deemed to have information which is not generally available save in some instances.

It is interesting to note that the Securities Commission now has civil remedies pursuant to section 90 of the Act, which allows it to institute civil proceedings (in addition to criminal proceedings) in the court against a defaulting party who has contravened the provisions of the Division relating to insider trading, whether or not that person has been charged with an offence in respect of the contravention, or whether or not a contravention has been proved in a prosecution.

Such civil proceedings may be begun at any time within 12 years from the date on which the cause of action accrued or the date on which the Securities Commission or the plaintiff, as the case may be, discovered the contravention, whichever is later. This right to civil remedy is premised on the Securities Commission safeguarding the public interest. It may pursuant to section 89 of the Act, file a civil claim against an insider trader regardless of whether or not the insider or any other person involved in the contravention has been charged with an offence in respect of the contravention or whether or not the contravention has been proved in a prosecution.

The Securities Commission may recover an amount equal to three times the amount of the difference between the price at which the securities were disposed of, or agreed to be disposed of, by the insider or the other person, and the price at which they would have been likely to have been disposed of at the time of the disposal or agreement, as the case may be, if the information had been generally available. In addition, it may request the court to impose a civil penalty subject to a maximum of RM 500,000.

Sums recovered or obtained by the Securities Commission pursuant to such a civil remedy will first be applied towards reimbursement of all costs of the investigation and proceedings incurred by the Securities Commission. The balance towards compensating the sellers or buyers of the affected securities of the same class on the stock market of the

stock exchange when information was not generally available between the time of the insider trading and the time when information became generally available.

The Securities Commission also retains the right, if it considers it impracticable to compensate the affected buyers or sellers aforesaid, in view of the likely administration costs, the amount of any potential distribution to each person, and the difficulty of ascertaining or notifying the persons whom it is appropriate to compensate, as the case may be, to withhold such distribution. Such sums will then be retained by the Securities Commission to defray the costs of regulating market trading with the approval of the Minister of Finance.

Pursuant to section 90A, a person who suffers loss or damages by reason of, or by relying on, the conduct of an insider trader may recover the amount of loss or damages by instituting civil proceedings against the other person, whether or not the other person has been charged with an offence in respect of the contravention, or whether or not a contravention has been proved in a prosecution. A claim for loss or damages includes an unrealised loss or gain, as the case may be, in the price or value of securities of a corporation, being the difference between:

- The price or value of securities in a transaction in connection with which the aggrieved person claims to have suffered loss or damages; and
- The price which would have been the likely price of the securities in the transaction, or the value which it is likely that such securities would have had at the time of that transaction, if the contravention had not occurred.

There are many other prohibited market practices, such as short-selling, market manipulation, and providing false information, which carry a heavy penalty on conviction. The Securities Commission has introduced Guidelines on Securities Borrowing Also, Lending In Malaysia in 1998 by permitting stock broking firms to borrow and lend securities listed on the Kuala Lumpur Stock Exchange. In a sense, this is a controlled form of short selling which the regulators felt would benefit the market. Elements of a securities borrowing and lending transaction have been defined to include the following:

- The borrowing of securities for a period of time;
- The borrower simultaneously or previously providing the lender with collateral;
- The lender earning a fee (or returns on the reinvestment of cash collateral) as consideration for the loan of the securities;
- An outright disposition of the securities by the lender of the securities to the borrower taking place;
- The lender being able to recall the loaned securities at any time during the loan after serving adequate notice;
- At the end of the loan period, the borrower returning replacement securities to the lender which are of the same number and type as the original securities.

All participants planning to engage in securities borrowing and lending must ensure that they have obtained the prior authorisation of the Securities Commission. The

Securities Commission would grant its authorisation to domestic participants only if the following minimum criteria are met:

- An applicant must be the holder of a dealer's licence or be declared an exempt dealer who is authorised to engage in securities borrowing and lending, under the Securities Industry Act 1983;
- An applicant must demonstrate that it conducts, or is capable of conducting, its securities borrowing and/or lending business in a prudent manner having regard to the nature and scale of its operations and the risks inherent in those operations; and
- An applicant must demonstrate that its securities borrowing and lending business is or will be carried on with integrity and with the professional skills appropriate to the nature and scale of its business.[21]

The Securities Commission has been rigorously prosecuting offenders in recent years as the onslaught of financial crises between 1998 and 1999 had regularly seen corporate failures and abuses which have affected investors' confidence.

Extra-Territorial Application

A new section 89P was introduced to the Securities Industry Act, which came into force in October 1998. Section 89P extended the coverage of insider trading to:

- Acts and omissions occurring within Malaysia in relation to securities of any body corporate which is formed or is carrying on business or is listed within or outside Malaysia; and
- Acts and omissions occurring outside Malaysia in relation to securities of any body corporate which is formed or is carrying on business or is listed within Malaysia.

There have not yet been any cases that have come to the Malaysian courts that have tested the provisions of these new sections in the Securities Industry Act. With the expanded scope of coverage and powers granted to the Securities Commission, Malaysia should see more transparent dealings in securities trading as the Securities Commission has made known their tough stand on any abuses of the Securities Commission Guidelines or relevant legislation.

Public Take-over Bids

In General

Public take-over bids of companies are governed by the Malaysian Code on Take-overs and Mergers 1998 (the 'Code') which was enacted pursuant to section 33A(1) of the Securities Industry Act. The Code, therefore, has the force of law, and criminal penalties will apply for non-compliance.

21 At the minimum, the applicant must demonstrate that it has established written policies and procedures governing its securities borrowing and lending activities.

The Code applies to parties having obtained control in a company and also to parties who hold more than 33 per cent, but less than 50 per cent, of the voting shares of a company and such party acquires in any period of six months more than two per cent of the voting shares of the company. A threshold of 33 per cent of voting shares in a company is set as a level at which a mandatory take-over offer must be made to the shares not already held by the party and to those acting in concert with it to seek control over the company.

It is interesting to note that, under Practice Note 1.2 issued pursuant to the Code, it is provided that the Code shall apply to a take-over of a private company which has either shareholders' funds or a paid-up capital of RM 10 million or more based on the latest audited accounts (on a consolidated basis, if applicable), as the case may be, and where the purchase consideration for the voting shares over a period of 12 months is RM 20 million or more.

Territorial Application (Foreign Bidder–Domestic Target)

As a general rule, a foreign bidder can technically bid for all the available shares in a Malaysian target company. However, the successful bidding of any such company also must meet the requirements of the Securities Commission Guidelines, which include the need to achieve a public shareholding spread as discussed above.

In addition, there are the Foreign Investment Committee requirements that the Bumiputra content of at least 30 per cent interest must be restored, although this content also may be incorporated into the public shareholding spread requirements.

For companies with a national-interest element, such as Telekoms and Petronas Dagangan, the foreign content cannot exceed a fixed amount as determined by the Securities Commission, which generally is set at 30 per cent or less. In such event, it would not be possible for a foreign bidder to make any take-over offers of such companies at all.

The Securities Commission Guidelines also impose reporting requirements on public companies to submit regular reports on the public spread and list of substantial shareholders. Some companies must, in compliance with the Securities Commission Guidelines, maintain a cap on foreign participation, established a two-tier shareholding structure, ie, one for local shareholders and one for foreigners.

Procedural Requirements

The Practice Notes have set out specific guidelines on the procedures in relation to the mechanism of undertaking a take-over offer. Parties are advised by the Securities Commission to seek advice from advisers who have the necessary expertise and experience. The board of directors of any offeree should seek independent advice from such advisers. Any aggrieved minority holder of voting shares of either the offeror or offeree wishing to seek a ruling by the Securities Commission should seek advice from such advisers.

Any adviser giving advice or submitting applications to the Securities Commission should be competent and of high professional standard since they would also be responsible for the advice given.

If the Securities Commission finds that the advice is not competent or results in the parties breaching the Code, the Securities Commission may refuse to accept any submissions on matters relating to any take-over offer, merger, or compulsory acquisition from any such adviser for a period of six months. A submission made to the Securities Commission must include the following:

- Brief information of the offeror and the offeree (detailed background information should be attached as appendices);
- Details of the transaction from which an obligation to undertake a mandatory general offer arises;
- Details of all persons acting in concert (if any);
- Requests and justification for an exemption or a ruling applied for; and
- Such other details considered relevant for the Securities Commission's consideration.

Exemptions

The Practice Notes set out various criteria on which applications for exemptions may be entertained by the Securities Commission from making a mandatory general offer.

In relation to an application for such an exemption, consultation with the Securities Commission at an early stage is essential, and applications for an exemption should be submitted prior to the obligation to make a mandatory offer arising. There are 10 general situations in which an exemption from making a mandatory general offer may be made to the Securities Commission under Practice Note 2.9.1 of 2 September 1910, which are:

- Practice Note 2.9.1 — Exemption if transactions involve issue of new securities;
- Practice Note 2.9.2 — Exemption if convertible securities are exercised;
- Practice Note 2.9.3 — Exemption if rescue operation;
- Practice Note 2.9.4 — Exemption arising from foreclosure of voting shares;
- Practice Note 2.9.5 — Exemption from a general offer involving placement of securities having voting shares;
- Practice Note 2.9.6. — Exemption if the remaining holders of voting shares of a company have given written undertakings not to accept an offer;
- Practice Note 2.9.7 — Exemption in transactions involving acquisition of additional voting shares by members of a group acting in concert in specified situations.
- Practice Note 2.9.8 — Exemption in compulsory acquisition circumstances;
- Practice Note 2.9.9 — Exemption based on national policy; and
- Practice Note 2 September 1910 — Exemption for holders of voting shares, directors, and persons acting in concert when a company purchases its own voting shares.

Recognition of Foreign Take-Over Regulation

The Securities Commission is under a statutory duty[22] to consider a written request from a foreign supervisory authority for assistance to investigate into an alleged breach of a legal or regulatory requirement which the foreign supervisory authority enforces or administers, provide assistance to the foreign supervisory authority by carrying out an investigation of the alleged breach of the legal or regulatory requirement, or provide such other assistance to the foreign supervisory authority as the Securities Commission thinks fit.

Jurisdictional Conflicts

In the 1980s, Malaysia saw the banking scandal involving Bank Bumiputra Malaysia Bhd and the lending to the Carrian group of companies in Hong Kong. The case brought about interesting legal arguments concerning jurisdictional issues of whether a Malaysian court will exercise jurisdiction over breaches of directors of a foreign company. In *Bank Bumiputra Malaysia Bhd* v *Lorrain Esme Osman,*[23] Bank Bumiputra Malaysia Finance Ltd (BMF), a Hong Kong company, sued its Malaysian director for fraudulent misrepresentation and breach of fiduciary duties.

BMF is a wholly owned subsidiary of Bank Bumiputra Malaysia Bhd (BBMB), a Malaysian company. The judge, Zakaria Yatim J, held that the applicable law to the substantive issues was the law of Malaysia, even though the actionable wrong was governed by both Hong Kong (on the basis of *lex loci delicti*, law of the place where breach occurred) and Malaysia laws (on the basis of *lex fori*, the law of the forum). He came to the conclusion on account that BMF is a subsidiary of a Malaysian bank, the director is a resident of Malaysia, and board meetings which authorised the unlawful transactions took place in Malaysia.

Academics have argued that, in adopting this approach, the court has probably followed the 'proper law approach' by focusing on the law of the relationship between the affected director and BMF as to whether the issues that arose out of the breach have the closest and more real connection with the relevant law.

While Malaysia may develop its own jurisprudence in relation to its approach to jurisdictional conflicts, the recent Singapore decision of *Sumitomo Bank Ltd* v *Kartika Ratna Thahir*[24] may be persuasive in Malaysia. In that case, a director of an Indonesian company amassed substantial wealth illegally, which he deposited in Singapore banks.

When the director died, his widow and sons made a claim on the money. The Indonesian company intervened to stake a proprietary claim on the proceeds on account of secret profits being made by the director which he should properly account to his company. The Singapore court held that the Indonesian company has a right to those monies. The

22 Securities Industry Act, s 43B(1).
23 *Bank Bumiputra Malaysia Bhd* v *Lorrain Esme Osman* [1987] 1 MLJ 502.
24 *Sumitomo Bank Ltd* v *Kartika Ratna Thahir* [1993] 1SLR 735.

decision is affirmed by the Singapore court of appeal, thus paving the way for a Singapore court to find jurisdiction over the acts of a director in a foreign country.

Malaysia, being a Commonwealth nation, naturally adopts the legal principles of conflict of laws associated with the English approach as illustrated in the *Bank Bumiputra* case above. The Malaysian Federal Court, in *Government of Pakistan* v *Seng Peng Sawmills Sdn Bhd*,[25] cited with approval that:

> . . . the rule had not changed that, in the Comity of Nations, no sovereign power is amenable to the process of Court of another sovereign power outside its jurisdiction.

25 *Government of Pakistan* v *Seng Peng Sawmills Sdn Bhd* [1978] 1 LNS 54.

Mexico

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Mexico

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Introduction

In General

Since 2006, Mexico has had a new securities law and regulation that allows listing and trading in the local exchange securities issued by both non-Mexican entities and foreign securities with admission and listing requirements very similar to those required for Mexican securities or Mexican issuers.

Mexico's legal system is based on the Civil Law tradition and its legal framework is contained mainly in statutes and codes enacted by the legislative power and secondary statutes (*reglamentos*) approved by the executive power, and only secondarily governed by case precedents or judicial resolutions (*jurisprudencia*) issued by the Supreme Court and other upper courts of the judicial system. The legislative power is divided into two chambers, the Representatives Chamber (*Cámara de Diputados*) and the Senators Chamber (*Cámara de Senadores*).

In 2005, after intense months of debate, the legislative power approved the current Mexican Securities Market Law (*Ley del Mercado de Valores*, the 'Securities Law'), which became effective 2006. The Securities Law confers the executive power, specifically the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) (the 'Banking and Securities Commission'), the authority to interpret the Securities Law as well as to issue secondary regulations in connection with the Securities Law.

Since becoming effective, the Securities Law boosted the Mexican economy by setting a clear and orderly framework for investors and companies to participate in financial markets as well as to support financial markets as an alternate option to lending and credit.

After the 2008 financial meltdown, the United States consumers' behavior changed dramatically resulting in unexpected variation of Mexican exports. Additionally, Mexico suffered a dramatic decrease in oil production, which is the source of a significant portion of fiscal revenues. Without the exportations' income and a plumbing oil production, the Mexican government implemented

several reforms to boost local markets and to adopt a prudent fiscal stance. The government also is considering further tax reforms to straighten financial markets and reduce dependence on oil-related receipts.

With activity well below potential, inflation is projected to reduce gradually. This gives monetary policy and financial regulation some leeway to remain accommodative and support the recovery.[1] In January 2014, a new financial reform (the '2014 Financial Reform') to 34 financial laws and regulations, including the Securities Law, was approved and became effective. The 2014 Financial Reform was designed to provide for a healthier and more solid development of the Mexican financial industry, and to modernize financial laws and regulations; the foregoing, in order to promote better access for funding and credit. Where needed, selected amendments to securities laws and regulations pursuant to the 2014 Financial Reform are included in this chapter only as applicable to its scope and content.

Regulatory System

The main regulator of the Mexican Securities Market is the National Banking and Securities Commission, which depends on the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*, the 'Ministry of Finance'). It is organized and governed by the Banking and Securities Commission Law (*Ley de la Comisión Nacional Bancaria y de Valores*, the 'Banking and Securities Commission Law').

Legal Sources

The main securities legal framework consists mainly of:

- The Securities Law;
- The General Regulations applicable to Issuers of Securities and other participants of exchange markets (*Disposiciones de Carácter General Aplicables a las Emisoras y a Otros Participantes del Mercado de Valores*), issued by the Banking and Securities Commission (the 'Banking and Securities Commission Regulations');
- The Mexican Securities Exchange Internal Regulations (*Reglamento Interior de la Bolsa Mexicana de Valores*, the 'Mexican Securities Exchange Regulations');
- The Broker-Dealers Sole Circular (*Disposiciones de Caracter General Aplicables a las Casas de Bolsa*, the 'Broker-Dealers Circular');
- The General Law of Negotiable Instruments and Credit Transactions (*Ley General de Títulos y Operaciones de Crédito*); and

1 Mexico Economic Outlook, Organization for Economic Cooperation and Development Country Summary; see http://www.oecd.org/document/26/ 0,3746,en_33873108_ 33873610_45270042_1_1_1_1,00.html.

- The Banking and Securities Commission Law (*Ley de la Comision Nacional Bancaria y de Valores* (together with the Securities Law, the Banking and Securities Commission Regulations, the Mexican Securities Exchange Regulations, the Broker-Dealers Circular, and the Banking and Securities Commission Law, the 'Securities Regulations').

Authorities

The main authority and regulator of the Mexican financial system is the Banking and Securities Commission. The Banking and Securities Commission is vested with the authority to supervise financial markets and financial entities, issue financial regulations within its faculties, authorize the registration of securities for public offerings in Mexico, authorize and license regulated financial entities to provide financial services in Mexico, impose penalties to financial entities and participants of financial markets, provide advice and clarification to the federal government in connection with financial regulation, and publish financial studies, analysis, and statistics and perform as liquidator of financial entities.[2]

The Ministry of Finance also is authorized to issue secondary regulations in connection with financial services and financial entities, mainly in connection with capital requirements and anti-money laundering. Also, the Mexican Central Bank (*Banco de México*) is authorized to issue circulars and regulations applicable to financial entities (mostly banks and broker-dealers) in connection with foreign currency, derivative transactions, and capital requirements in connection with specific transactions.

Additionally, the National Commission for the Protection and Defense of Financial Services Consumers (*Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros*, CONDUSEF) acts as a consumer protection agency specialized in financial services.

The CONDUSEF performs mostly as an information agency requiring financial institutions to inform their clients with transparency about their services, risks, and fees as well as providing consumers of financial services comparative information over financial services and entities to make easier for them the taking of an informed decision.

As of the 2014 Financial Reform, financial institutions are granted amnesty regarding non-criminal, non-serious infractions to the Securities Regulation if such financial institutions voluntarily file self-correction plans with the Banking and Securities Commission.

Procedures

The public offering of securities in Mexico requires the prior filing of a statement for approval with the Banking and Securities Commission for any

2 Banking and Securities Commission Law, art 4.

securities to be publicly offered in Mexico. The relevant securities must be registered at the National Registry of Securities (*Registro Nacional de Valores*, RNV) of the Banking and Securities Commission and listed at the Mexican Securities Exchange to be allowed for trading in the Mexican Securities Exchange.

As of the 2014 Financial Reform, it is possible for issuers to carry out a public offering targeted specifically at a type of investor, allowing for a wider spectrum of market specialization. The RNV contains a database with all relevant information of listed securities. All issuers must file information documents with the Banking and Securities Commission and the Mexican Securities Exchange simultaneously to having their securities recorded at the RNV and listed in the Mexican Securities Exchange. Filings are made electronically through proprietary systems and in printed form in both of the Banking and Securities Commission and the Mexican Securities Exchange.

The Banking and Securities Commission also is authorized to implement internal administrative procedures to solve disputes between financial entities and the Mexican Securities Exchange as well as to reconsider fines and sanctions applied to financial entities and other participants of financial markets.

Legal Order and Regulatory Interests

Admission

Market Participants

In General. Non-Mexican entities follow the same procedures as Mexican companies to list their stock in the Mexican Securities Exchange. The companies must file a registration statement, a prospectus, opinions, financial statements, agreements, corporate resolutions, and any other relevant documents simultaneously with the Banking and Securities Commission and the Mexican Securities Exchange, who review and comment on such documents.

Marketing of securities is allowed after the first filing of the relevant documents. Usually, after a number of turnarounds, the Banking and Securities Commission and the Mexican Securities Exchange approve the prospectus, the form of securities certificate, and other information documents allowing the company to sell the relevant securities through the Mexican Securities Exchange. In addition to the regulators and the investors, the main market participants in the offering of securities are the following:

Placement Agent or Underwriter. Placement agents are Mexican broker-dealers. They structure the deal, have contact with prospective investors, build the book, and have contact with regulators. The placement agent markets the securities and is liable for most of the prospectus content.

Independent Legal Adviser. The independent legal adviser issues the legal opinion that states that the issuer entity is in good standing and in position to

issue the securities. Additionally, the independent legal advisor usually reviews the offering documents and signs the prospectus to be liable in connection with the relevant legal information.

Independent Accountant. The independent accountant reviews the entity's financial statements and issues an accountant's opinion with respect to the entity's audited financial statements. The independent accountant signs the prospectus and is liable in connection with the financial information contained therein.

Rating Agencies. In the event a financial rating is required regarding the type of security, the rating agencies give comments to the preliminary forms of prospectus and other offering documents. The rating agencies are not liable for the content of the prospectus.

Other Advisors. Depending on the complexity of the deal, the parties may hire additional advisors. For example, it is very common for the placement agents to have their own legal counsel, who does not sign the prospectus.

Domestic Exchanges

The Mexican Securities Exchange is the only securities exchange currently in place in Mexico. Foreign companies may be listed in the Mexican Securities Exchange. Many non-Mexican companies are listed in the Mexican Securities Exchange such as Banco Bilbao Vizcaya Argentaria, SA, Citigroup Inc, Fresnillo Plc, and Banco Santander, SA.

Other exchange markets in Mexico include the MexDer (www.mexder.com.mx), which is a derivative agreements market only. Business contracts are not considered securities for purposes of the Securities Law; however, in the event underlying assets of a derivative instrument consist of listed securities, such derivative agreement may be considered as security for purposes of the Securities Law.

Transborder Electronic Trading Systems

The Mexican Securities Exchange Regulations provide for a transborder electronic system *Sistema Internacional de Cotizaciones* (International Quotations System, SIC).[3] Securities traded on the SIC are securities listed and traded in foreign exchanges and not listed or traded in Mexico through the Mexican Securities Exchange. The SIC is a trade window that allows the trading of securities listed in recognized foreign exchanges, as if such trading were being made in the foreign exchange where the relevant securities are listed. Such trading was limited to non-Mexican residents, qualified investors, and

3 Additionally, the SIC is regulated by articles 262–264 of the Securities Law and the General Rules applicable to the International Quotation System.

institutional investors, but as of the 2014 Financial Reform, trading in the SIC may be done by any entity or individual.

The Mexican Securities Exchange must recognize and register a specific exchange market or the specific issuer of the respective security for such exchange or security to become traded into the SIC. Local broker-dealers or the Mexican Securities Exchange may initiate process for the acknowledgement procedure of a foreign exchange and/or security and shall become liable to provide the Mexican Securities Exchange with all the periodical and extraordinary information in its original language as it is provided by such issuer in the corresponding exchange.

The Mexican Securities Exchange may request from broker-dealers a summary in Spanish of such information. Transactions completed in the SIC are not considered to take place in Mexico and thus are not subject to the supervision of the Banking and Securities Commission.

For purposes of the Securities Regulations, institutional investors are Mexican financial entities as well as any other Mexican entities considered as institutional investors by statute such as banks or other financial entities. Qualified investors are any persons that, during the prior fiscal year, maintained investments in securities in an amount equal to or greater than 1,500,000 Investment Units (UDIs) or that obtained a minimum gross income equal or greater than 500,000 Investment Units (UIDIs) during the prior two fiscal years.

Although the Securities Law and the Banking and Securities Commission Regulations are silent if such investments should be kept within Mexico or in foreign financial markets, the definition of 'securities' under the Law includes securities regulated by non-Mexican laws and regulations as mentioned below.

The SIC is divided in two sections, ie, SIC debt and SIC stock. Both sections require, among others, that broker-dealers evidence that the relevant securities are listed and traded in, and thus supervised by, a foreign financial market or exchange.

Off-Market Transactions

Generally, all securities subject to public offerings must be listed and all transactions with listed securities must be performed by authorized financial intermediaries in the market through the Mexican Securities Exchange.[4] Off-market transactions with securities are only allowed as an exemption to the abovementioned rule. Such exceptions are the following:

- Private placements — Any entity or individual may perform private placements in Mexico when such offerings are made to institutional or qualified investors only, there are less than 100 investors (in case of the stock

4 Securities Law, art 179.

of a company)[5], employees of the issuer company invest through employee stock option plans, and entities or individuals perform their main corporate purpose or business with the issuer company. The Securities and Banking Commission may authorize other kinds of private placements, considering the number of investors to whom such private placement will be addressed, as well as general principles of the Securities Law.[6] As of the 2014 Financial Reform, any securities issued in Mexico or by a Mexican issuer that are privately traded outside of the Mexican territory in foreign stock exchanges must be notified to the CNBV. Mexican broker dealers and/or any other entities authorized for the offering of securities in Mexico are prohibited to offer securities that are not registered with the RNV and that do not represent the capital stock of a legal entity. Securities eligible for registration with the SIC are not eligible for private placements.

- Foreclosure of Securities Pledge Agreements — There is a specific form of collateral interest over listed securities called securities pledge (*prenda bursátil*). When a debtor breaches secured obligations under a specific securities pledge, the lender is allowed to foreclose collateral without a judicial procedure or, as of 2014, to retain possession and ownership of the collateral as payment in kind[7] if *ab initio* the ownership of the shares was transferred by the pledgor to the pledgee.
- Transfer of Securities after owners' instructions to broker-dealers — Clients of broker-dealers may instruct them to register transfers of securities under specific conditions where the broker-dealer had no participation in the specific transaction and are registered without the participation of the market. These kinds of transaction are common as a consequence of last wills' transfers, good management strategies, and other non-market driven transactions.[8]

Securities not subject to public offerings in Mexico and thus not listed in the Mexican Securities Exchange, are not subject to Mexican financial regulation and the supervision of the Securities and Banking Commission.

Securities

In General

The Securities Law defines securities as any shares, equity quotas, debentures, debt obligations, bonds, options, certificates, promissory notes, and any other documented debt obligations, whether nominated or not, listed or not in the RNV, that may be listed in the Mexican Securities Exchange, massively issued or in series, and which represent an interest in the capital stock of a company, a

5 The Securities Law is silent regarding the private offering of debt securities in Mexico to investors other than institutional or qualified investors. A definition in this regard would require the issuance of a ruling by the Securities and Banking Commission.

6 Securities Law, art 8.

7 Securities Law, art 204.

8 Securities Law, art 179.

participation in a loan, or any other creditor right in terms of Mexican or foreign laws.[9]

National Treatment and Reciprocity

The Securities Law gives the same treatment to securities issued pursuant to Mexican law and securities issued under foreign laws and regulations. As a principle under Mexican law, the only limitation to such reciprocity would be Mexican public order.

In other words, if a security issued under non-Mexican regulation were to be legally deemed to be contrary to Mexican public order, such security will not be allowed in the Mexican Securities Exchange. Non-Mexican issuers may find additional listing requirements to list securities in the Mexican Securities Exchange in the event they already have securities listed in another foreign securities exchange.

Issuer Requirements

Mexican companies whose equity is listed in the Mexican Securities Exchange may be either incorporated in the form of a publicly-held limited-liability corporation called *sociedad anónima bursátil* (SAB) or in the form of a more flexible limited-liability corporation created to support new business and ventures called *sociedad anónima promotora de inversión bursátil* (SAPIB). The shares of a SAB or a SAPIB may be acquired by any entity or individual.

The SAB is the most common form of listed companies. SAPIBs are used to support new businesses and to raise capital for new ventures. SAPIBs must turn into SABs within 10 years after listing their shares, or before such time if their net worth exceeds the equivalent of 250,000,000 UDIs but must comply with later listing requirements in the Mexican Securities Exchange. In any event, public companies must adopt minimum corporate governance requirements set forth in the Securities Regulations as well as commercial practices of financial markets.

Foreign companies follow the same procedures as Mexican companies to list their stock in the Mexican Securities Exchange. The companies must file a registration statement, a prospectus, opinions, financial statements, agreements, corporate resolutions, and any other relevant documents simultaneously with the Banking and Securities Commission and the Mexican Securities Exchange, who review and comment on such documents. Marketing of securities is allowed after the first filing of the relevant documents.

Usually, after a number of turnarounds, the Banking and Securities Commission and the Mexican Securities Exchange approve the prospectus, the form of securities certificate, and other information documents allowing the company to sell the relevant securities through the Mexican Securities Exchange. Regular

9 Securities Law, art 2, s XIV.

companies must have at least 200 stockholders, whereas SAPIBs must have at least 20 stockholders. No minimum trading record is required. The company must report profits during the prior three fiscal years. In the event the specific company to be listed is a SAPIB, it must report income only during the prior two years. The working capital requirements are UDIs 20,000,000 for SABs and UDIs 15,000,000 for SAPIBs.

Securities Requirements

The general public must hold at least 15 per cent of a SAB's capital stock. If the relevant company is a SAPIB, the general public must hold at least 12 per cent of its capital stock. At least 50 per cent of such capital stock must be distributed among investors who acquired no more than five per cent of the listed securities. No investor may acquire more than 40 per cent of the listed securities.

Prospectus Requirements

All prospectuses are governed by general principles of relevance and disclosure and all material information must be mandatorily disclosed. The information required for making an informed investment decision shall be legally deemed to be material information. A prospectus must contain, in general terms, the following information:

- General information regarding the securities;
- Executive summary of the transaction;
- Risk factors;
- Main destiny of the funds to be obtained from the public offering;
- Structure of the company before and after the public offering;
- Distribution plan;
- Dilution risks;
- Detailed information about the issuer company, such as a description of its businesses, existing litigations, corporate structure, and main shareholders;
- Financial information of the issuer company and its group, as well as any other entity that contributed 10 per cent or more to the issuer company's income or total sales in the previous year;
- Management structure and politics;
- Main assets and liabilities; and
- Responsible parties and individuals to provide information to the Banking and Securities Commission and the Mexican Securities Exchange.

The prospectus and other offering documents are prepared by the issuer with the advice of the placement agent and the external advisers. The placement agent, several officers of the issuer, the independent accountant, and the independent legal advisor are liable for the information contained in the prospectus and the

offering documents within the scope of their professional expertise. There may be other information prepared by specific advisors, such as studies over a specific kind of assets or valuations of the company's assets.

Corporate Governance

A SAB's management is performed by a board of directors and a general director. The board of directors is composed of a maximum of 21 members, and at least 25 per cent of such members must be independent.

The board of directors is supported by several committees. Some of these committees are mandatory, such as the corporate practices committee (*comité de prácticas societarias*) and the auditing committee (*comité de auditoría*). These committees are formed by at least three independent members of the board of directors. The main functions of the board of directors are to:

- Establish the business and corporate strategy;
- Supervise the management and operation of the company as well as the company's advisors;
- Approve internal policies for granting loans and credits as well as managers' compensations;
- Appoint the general director of the company; and
- Submit to the shareholders' meeting a detailed annual report and financial information in connection with the operations of the company.

The members of the board of directors must comply with duties of care and loyalty and avoid acting under any form of conflict of interests as set forth in the Securities Regulation and securities practices. The main functions of the general director are to:

- Submit for the approval of the board of directors the business strategy of the company;
- Execute and comply the resolutions of the shareholders' meetings, as instructed;
- Submit to the auditing committee internal politics for control;
- Sign off on all periodic information submitted to investors in connection with his areas of expertise;
- Disclose any relevant information or events to which he is obligated to disclose pursuant to the Securities Regulation;
- Keep the accounting systems, records, and files of the company;
- Submit an annual report to the board of directors of the company; and
- Exercise any action to obtain reparation for any form of damage against the company.

Registration of Public Offerings

Filings for equity public offerings include the following documents:

- Registration statement;
- Copies of powers-of-attorney of all documents' signatories;
- Articles of incorporation and by-laws of the issuer company;[10]
- Corporate resolutions approving the public offering;
- Form of stock certificate;
- Audited financial statements;[11]
- Independency letters;
- Legal opinion;
- Placement agreement;
- Prospectus; and
- Public offering notices.

No offering or marketing of securities is allowed before filing of the preliminary prospectus and the rest of the offering documents, even if in preliminary form. Once these documents are filed with the Securities and Banking Commission and the Mexican Securities Exchange, the placement agent may initiate contacting prospective investors, reach clients via conference calls, or start the road show to market the securities.

The underwriter may only market the securities with information contained in the offering documents that they have been filed before the Securities and Banking Commission and the Mexican Securities Exchange. Only after the relevant securities have been registered in the RNV may said securities be traded in the Mexican Securities Exchange. The General Manager, the General Counsel, and other officials such as the head of the accounting department of an issuer are, within their respective authority, responsible for the information contained in the reports and financial statements that must be disclosed to the public and/or filed with the National Banking and Securities Commission or the Mexican Stock Exchange.

Registration of Placements

Whereas the Banking and Securities Commission must previously approve public offerings of specific securities that are to be carried out within Mexican territory, the actual placement transaction is not subject to its authorization. The very act of placement of securities is subject only to recordation by the Mexican Securities Exchange. The placement of securities usually occurs at the same date for the offering of such securities, after following a book-building system.

10 Subsequent equity offerings do not require this filing.
11 Subsequent equity offerings do not require this filing.

Book-building is still the most used marketing strategy for public offerings in Mexico. Usually, underwriters that market securities among institutional investors and financial intermediaries in the primary market tend to use the book-building system. Retail offers are managed directly by broker-dealers with their clients usually by means of electronic auction systems. The issuer must publish a public notice on the same date the relevant securities are offered and assigned through the Mexican Securities Exchange informing the investors that the relevant securities have been purchased in the market.

Registration of Secondary Trade

It is not required to obtain a specific authorization from the Banking and Securities Commission for secondary trading of securities. Secondary trading is simply recorded by the Mexican Securities Exchange and the specific broker dealers.

However, any person or entity that directly or indirectly as a result of one or more transactions holds 10 percent or more but less than thirty percent of a public company's stock listed in the Mexican Securities Exchange must inform to the public investors, through the Mexican Securities Exchange, said ownership the business day following the meeting of such threshold.

Furthermore, any person or entity that directly or indirectly holds 10 percent or more of a public company's stock listed in the Mexican Securities Exchange as well as any member of the board or relevant officer of the listed company must inform the Banking and Securities Commissions about the purchase or sale of securities of the relevant company in the following instances:

- If the amount of the transactions is equivalent or superior to UDIs 1,000,000 and the relevant transactions were performed within a calendar quarter of the year, such transactions must be informed within five business days after the end of said quarter; and
- If the amount of the transactions is equivalent or superior to UDIs 1,000,000 and the relevant transactions were performed within five days, such transactions must be informed the next business day after such transactions were completed.

A purchase of a significant participation in the capital stock of a public entity (ie, representing more than 30 per cent of the public entity's capital stock means the acquisition of the control of the public entity) will trigger the obligation to carry out a mandatory public tender offer.

Periodic Disclosure

In General

Public companies have three main obligations, ie, to report, to inform, and to disclose.

Reporting Obligations

Public companies must provide the following:

- Annual reports — This information updates the prospectus or the last annual report. These reports include the company's annual audited financial statements. Additionally, public companies must inform about their capital structure, the board members that are holders of one per cent or more of the company' capital stock, and the investors that hold five per cent or more of the company's capital stock.
- Quarterly reports — This information is filed pursuant to certain forms provided by the Banking and Securities Commission. These reports include the company's pro forma quarterly financial statements. The issuers of debt instruments in credit receivable securitization transactions also must report monthly specific financial information, including revenues and collection reports.
- Information — Public companies must inform investors about any shareholders' meeting, corporate restructure, or merger as well as any other notices addressed to their shareholders through the Mexican Securities Exchange within the time frames set forth by the Mexican Securities Exchange Regulations.
- Disclosure — Public companies must reveal to the general public, through the Mexican Securities Exchange, any relevant event that may affect the price or value of the stock. To determine if a specific event is relevant to investors, the company must consider whether the specific event is equivalent in value to five per cent of the company's assets, liabilities, or consolidated capital, or three per cent of the previous year's total sales. If it is not possible to determine if the specific event is relevant according to such criteria, the company must consider whether the event constitutes relevant information for investors to make an investment decision so as to understand the real situation of the company, or that may affect the value of the stock.

Official Trade

The average daily volume of stock securities traded in the Mexican Securities Exchange is p$14.4 thousand million and 384.2 million shares. The debt market is more active than the equity market. The number of issues traded in the debt market is variable considering there are short and long-term issues being traded at the same time that are constantly paid or cancelled.[12]

Regulated Market

The Mexican Exchange Market is a self-regulated entity and its fluctuations are determined by supply and demand of securities. The Securities Regulations set forth minimum capital requirements and standards for transactions in general

12 Annual Report 2013, *Bolsa Mexicana de Valores, SAB de CV.*

terms. The Securities Regulations do not regulate prices or trading of specific securities.

Free Trade

Only securities subject to public offerings in Mexico are subject to the regulation and supervision of the Banking and Securities Commission. Regular securities and commercial transactions that are not subject to financial intermediation or listed in an exchange are not subject to any form of supervision or control by the Banking and Securities Commission.

Foreign Issuers with Primary Admission

First-time foreign equity issuers are required to submit the following documents:

- Registration statement;
- Copies of powers-of-attorney of all documents' signatories;
- Articles of incorporation and by-laws of the issuer;
- Corporate resolutions approving the public offering;
- Form of stock certificate;
- Audited financial statements;
- Independence letters;
- Legal opinion;
- Placement agreement;
- Prospectus; and
- Placement notices.

Additionally, the by-laws of foreign entities must contain similar minority shareholders' rights as those provided under the Securities Regulations. Foreign entities are not obligated to comply with local corporate governance obligations.[13]

Foreign Issuers with Secondary Admission

Foreign issuers of subsequent equity public offerings are not required to file their articles of incorporation, by-laws, or audited financial statements.

Issuers without Ongoing Disclosure Duties

Issuers without ongoing disclosure duties that have listed securities in a foreign exchange and have securities listed in the Mexican Securities Exchange must file with the Banking and Securities Commission and with the Mexican

13 Securities Law, arts 58 and 59.

Securities Exchange all offering and periodical information submitted to the foreign exchange.

The Mexican Securities Exchange will be entitled to request from the relevant foreign issuer a summary of said information in Spanish. In the event the foreign issuer does not have any securities listed in any exchange, it will be required to file all applicable documentation to list securities as described above.

Privileged 'Foreign Private' Issuers

Besides the Mexican government, Mexican financial institutions, and other specific entities, only international multilateral financial entities (*organismos financieros multilaterales*) to which Mexico is a party are 'privileged' for purposes of listing securities. This privilege consists in the possibility to perform a preventive listing of securities under a generic form (*inscripción preventiva, en su modalidad de genérica*).

This type of listing only requires generic information from the issuer and the security to be listed. Once it is obtained, it allows the issuer to issue securities on a regular basis and to market them in the Mexican Securities Exchange after obtaining the recordation of the securities in the RNV. The issuer must inform the Securities and Banking Commission about the new securities for it to register them no later than the next business day after they are placed in the market.[14]

Issuers of Registered Securities

In General

As mentioned above, issuers of registered securities will be required to file lesser documents and information to list new securities.

ADR Disclosure

Foreign issuers that concurrently have listed securities on the Mexican Securities Exchange and in other foreign exchanges (eg, ADRs on the New York Stock Exchange) have no restrictions under Mexican Law or the Securities Regulations to perform such issue and listing.

Mexican entities that issue and offer securities in foreign exchanges, and securities issued pursuant to Mexican Law and offered in foreign exchanges, whether directly or through trusts or similar vehicles, must inform the Securities and Banking Commission about the main characteristics of the issuance. This information does not result in a registration of the securities in the RNV. Such information is kept by the Securities and Banking Commission for information and statistical purposes only and thus the relevant securities may not be offered in Mexico unless under a private offering.

14 Banking and Securities Commission Regulations, art 10.

Proxy Disclosure

In General

Shareholders of a public company (SAB or SAPI) have the right to be represented in a shareholders' meeting by means of a proxy letter, including all the information specified in the Securities Law and the Securities and Banking Commission Regulations. Such proxy letters must disclose the following information:

- Specify in a clear manner the name of the company as well as the specific agenda; and
- Contain space in the document for the shareholder to address specific instructions as to how he wishes the agent to exercise the proxy letter.

The secretary of the board of directors is obligated to verify that the relevant proxy letters comply with these principles.[15]

Trading Rules

Trading of securities in the Mexican Securities Exchange is regulated by the Mexican Securities Exchange Regulations. There are two main structures for trading securities in the Mexican Securities Exchange:

- Continuous operation (*operación contínua*); and
- Public auction (*subasta*).

Pursuant to the continuous operation format, offers may be allowed and transactions may be completed at any moment during intraday operations. Pursuant to the public auction format, offers are only allowed during a specific offering period and, at the end of said period, the issuer of the best offer is entitled to the relevant securities.

Securities Offerings

In General

Only broker-dealers and banks allowed by the Mexican Securities Exchange to perform as intermediaries may perform as placement agents or underwriters pursuant to underwriting agreements they execute with their clients. Underwriting agreements for the marketing or securities may be structured either in a 'best efforts' (*mejores esfuerzos*) or a firm commitment (*en firme*) manner, although firm commitment underwriting agreements are uncommon in Mexico.

Green shoe options must be explicitly authorized by the Securities and Banking Commission or otherwise the placement agent will not be entitled to offer

15 Securities Regulations, art 49, s III.

additional stock. Stabilization activities are permitted by statute without a specific agreement; however, stabilization activities may only be performed with funds obtained from securities sold after exercising a green shoe option. Additionally, it is common practice to authorize main or leader placement agents to enter into sub-placement or placement participation agreements with other broker-dealers instead of having syndicated placement agreements.

Offer

The offering of securities may be performed whether primary or secondary in connection with the securities, and it may be either national (only in the Mexican Securities Exchange) or global (national and foreign concurrently) in connection with the exchange where the securities will be listed. Offerings may be performed under a program if the relevant securities are debt instruments.

Public

Any individual or entity may acquire any kind or security if its individual investment regime allows it. Some securities are designed for institutional and qualified investors but, any investor may acquire such instruments by representing that he, she, or it knows all risks related to said instruments, including such risks as extraordinary volatility or dependence to a third party for payment.

Place of Order

All trading transactions carried out in the Mexican Securities Exchange are performed through the Electronic System of Negotiations (*Sistema Electrónico de Negociación*) and formalized by means of special forms specified by the Mexican Securities Exchange. The transactions may only be perfected during trading hours; however, it is possible to submit purchase and sale offers outside trading hours.

Orders are placed by broker-dealers acting on their own behalf or on behalf of their clients. Broker-dealers must appoint authorized traders within the company, who are qualified individuals responsible for the passwords of the specific broker-dealer to enter into the Electronic System of Negotiations and to place orders.

Listed Securities

The Mexican Securities Exchange is a self-regulated entity that is divided into the following sections:

- Section I — Stock Securities;
- Section II — Stock Certificates of Investment Funds;
- Section III — Government Bonds;
- Section IV — Debt Securities;

- Section V — Options; and
- Section VI — Development Capital Certificates (*Certificados de Capital de Desarrollo*), which are equity/debt hybrid instruments.[16]

Delisting

A public company may be delisted either voluntarily or by order of the Banking and Securities Commission. Mandatory de-listings may be requested by the Banking and Securities Commission if the relevant security does not comply with the Mexican Securities Exchange listing requirements or if the company has breached its obligations under the Securities Regulations.

If the Banking and Securities Commission mandates the de-listing of a specific security, the company must launch a tender offer within the next 180 days addressed to those shareholders that are not members of the controlling group. The company must create a trust and transfer to funds to acquire the stock of the shareholders that did not attend to the tender offer.

In a voluntary de-listing, 95 per cent of the company's shareholders convened at a shareholders' meeting may resolve to de-list the company. In such event, the company must launch a tender offer. Tender offers require the prior authorization from the Securities and Banking Commission. The minimum time frame for a tender offer is 20 business days. Assignation will be prorated among all the shareholders that sold their stock until the end of the tender offer. The tender offer needs to be addressed to all shareholders, without regard as to whether they have limited vote stock.

Disclosure of Purchase of Substantial Holdings

Shareholder Duties

Shareholders that control, directly or indirectly, 10 per cent or more of a public company's capital stock, as well as members of the board and other relevant executives of said public company must inform the Securities and Banking Commission of purchases and sales of securities issued by the company they own, control, or provide services to, within the time periods mentioned above.

Company Duties

Public companies must inform the Banking and Securities Commission annually about its capital structure, the board members that are holders of one per cent or more of the company' capital stock, the investors that hold five per cent or more of the company's capital stock, and the 10 principal stockholders.

16 As of the 2014 Financial Reform, a new type of capital development certificate was introduced, specifically the development, commercialization, or management of real estate properties.

Insider Trading and Fraud

In General

The Securities Law sets forth that the use of privileged information (*información privilegiada*) is a crime (insider trading). Privileged information is any information that has or may have influence in the price of a specific security or the financial position of the issuer which has not been disclosed to the general public. The following individuals, among others, are deemed to have privileged information in connection with an issuer, unless otherwise proved:

- The members of the board, the general director, and any other relevant executive;
- The shareholders that hold 10 per cent or more of the issuer's capital stock (if the issuer is a financial company, such amount will be five per cent); and
- The persons who may reasonably access said privileged information and vary considerably their investment patterns.[17]

Individuals in possession of privileged information are not allowed to:

- Perform transactions with securities over which they possess privileged information;
- Transfer or disclose the privileged information to third parties unless, pursuant to their possession, it is their obligation to disclose such information; and
- Issue investment recommendations in connection with securities or issuers over which they possess privileged information or that may be affected by said privileged information.

As of the 2014 Financial Reform, public companies must maintain a record or list of the individuals who were privy to privileged information before it was disclosed to the general public.

Basis of Territorial Link

The information must be connected to securities listed and traded in the Mexican Securities Exchange; otherwise, this restriction will not be applicable. Learning privileged information, even through misappropriation, is not a crime under the Securities Law.

There is a crime however, when there is a purchase or sale of securities that may be influenced by said information or when there is a wrongful disclosure of said information to a third party.

17 Securities Law, art 363.

Extraterritorial Application

This restriction only applies to purchase or sale of securities in the Mexican Securities Exchange, despite where the privileged information was transferred or learned. Individuals who breach this principle may be subject to criminal responsibility in Mexico, resulting in considerable fines.

Thus, in the event the suspect is not located in Mexico, such fines may be imposed against any assets he has in Mexico or, if an extradition treaty is in place, it may be requested from the country of origin.

Public Take-Over Bids

In General

Public take-over bids may not be prevented contractually. Although poison pills may be included in the by-laws of the company, all transactions with listed securities must be performed through the market. In the event bidders are competing for a specific security under a public auction format, the best offer at the end will keep the relevant security.

Territorial Application (Foreign Bidder and Domestic Target)

Some specific industries have limitation in the amount and type of securities that foreign investors may acquire, such as the local financial services industry, mining, or agricultural industry. Foreign investment limitations are not described or analyzed in this chapter.

Otherwise, foreign bidders have no restrictions in comparison to local bidders. At the end of the auction period, the highest bidder will be entitled to the relevant securities pursuant to the Securities Market Law and the Mexican Securities Exchange Regulations.

International Private Law

Agreements governed by foreign law may be enforced in Mexico provided that such agreement is in accordance with local public order, agreements to perform an act other than payment of money and covenants, and other agreements not to perform an act are not specifically enforceable in Mexico, although any breach thereof may give rise to an action for money damages.

Procedural Requirements

The enforceability in Mexico of the terms of agreements governed by foreign law may be limited by bankruptcy, insolvency, reorganization, moratorium, and suspension of payments or other laws relating to, affecting, or limiting the enforcement of creditors' rights generally.

A final judgment rendered by foreign courts pursuant to a legal action instituted before such courts in connection with any agreements governed by foreign law

would be recognized by and valid and enforceable in the courts of Mexico (without any re-examination by such courts of the matters adjudicated by such judgment), provided that:

- The judgment has been rendered in an *in personam* action (an action against the person founded on a personal liability, as opposed to an action for a thing or action *in rem*);
- The Mexican courts do not determine that the obligation for which enforcement is sought violates Mexican law or public policy (*orden público*) or any international treaty to which Mexico is a signatory, or general principles of international law, insofar as procedural requirements are concerned;
- Process in the action has been served personally;
- The judgment is a final judgment according to the laws that govern said agreement;
- The judgment fulfils the necessary requirements to be considered authentic;
- The Mexican court before which enforcement of the judgment is requested will require a rogatory letter from the court that rendered the judgment, which rogatory letter must comply with the formalities provided for in the Federal Civil Procedures Code (*Código Federal de Procedimientos Civiles*);
- The courts of the country whose laws govern the agreement would enforce Mexican judgments as a matter of reciprocity;
- The action on which the final judgment is rendered is not the subject matter of a lawsuit among the same parties that is pending before a Mexican court, or resolved by definite judgments (*sentencia definitiva*) by a Mexican court that has previously served process (*prevenido*) or delivered a rogatory letter to the competent authorities in accordance with Mexican law; and
- The court issuing the judgment is considered competent under the rules internationally accepted and which are compatible with Mexican procedural laws.

Recognition of Foreign Take-Over Regulation/Compulsory Public Tender Offers

An investor or group of investors that intend to acquire 30 per cent or more of a public company's capital stock or the control of a public company must conduct a compulsory tender offer. The 30 per cent threshold does not refer to public float. Please note that during such tender offer, other bidders may offer a better price. As of the 2014 Financial Reforms, the penalties for non-compliance with the mandatory tender rules contained in the Securities Regulation can range from 10 to 100 per cent of the total value of the bid.

Jurisdiction Conflicts

In General

Most conflicts of laws under securities transactions are solved pursuant to contractual law. Governing law and competent courts will be the ones chosen by the parties in the relevant agreement.

A controversy that takes place in the Mexican Securities Exchange will be solved pursuant to the Mexican Securities Exchange Regulations and the procedures set forth therein before they are brought to a court. There is no precedent of a controversy derived from trading of listed securities brought to a court in Mexico.

Genuine and False Conflicts

Under Mexican law, the will of the parties is the main binding principle among them. As a general rule, if the parties agree to subject an agreement to foreign law and courts, the Mexican courts will have to enforce such agreement. If the parties agreed to subject the agreement to foreign law but Mexican courts are competent, such foreign law will be applied by the Mexican courts in the same terms that the foreign court would have applied it. Foreign law will not be implemented, *inter alia*, if:

- Such choice of law was made to wrongfully avoid fundamental principles of Mexican law and the judge determines the existence of such wrongful intentions; and
- The relevant foreign law or the result of implementing foreign law will contravene Mexican public order.[18]

If the parties did not agree upon a specific governing law or jurisdiction, the Mexican courts will be competent as long as the listed securities remain deposited in Mexico with a Mexican Central Depositary Institution (*Indeval*) and such agreement will be enforced in Mexico.[19]

As of the 2014 Financial Reform, it is now permitted to issue and deposit securities with the Depository Trust Company without actually physically issuing such securities, provided certain regulatory requirements are met.

Multilateral Approaches

In General

When several aspects or conditions of an agreement may be subject or governed by laws from different states or countries, all such laws will be applied

18 Federal Civil Code, art 15.
19 Federal Civil Code, art 13, ss III and V.

harmonically. The judge with jurisdiction is authorized to solve such controversy in an equitable manner using its own criteria.[20]

Substantive Law Solutions

Harmonization. As mentioned above, the judge with jurisdiction is authorized to solve such controversy harmonizing all applicable laws in an equitable manner using the court's own criteria.

Recognition. As mentioned above, foreign law may be applicable by Mexican courts when agreed by the parties or if such law is applicable pursuant to Mexican law. For such purposes, Mexican courts are entitled to obtain all required information in connection with the enforceability, currency, and interpretation of such foreign law, such as legal opinions or expert advice.

The Mexican Federal Civil Code is silent as to whether the cost of obtaining such information will be paid by the plaintiff, the defendant, or both.

Procedural Solutions

The law applicable to a specific transaction or agreement will be determined by applying the following:

- The binding relationship lawfully created in any of the states of Mexico or in a foreign state will be recognized in Mexico;
- The creation, regulation, and termination of real estate rights and lease rights over real estate property and movable assets will be governed by the laws where such assets are located; and
- The legal consequences of the agreements will be governed by the law of the place where such agreements will be fulfilled, unless the parties had legally agreed over a different governing law.[21]

20 Federal Civil Code, art 14, s V.
21 Federal Civil Code, art 15.

The Netherlands

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The Netherlands

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Introduction

In General

This chapter provides an overview of securities laws and regulations in The Netherlands.[1] First, a general overview of the regulatory system, the legal sources, authorities, and procedures is given. This chapter introduces the legislation, authorities, sources, and procedures that a practitioner may encounter when confronted with a securities problem involving The Netherlands.

The second section builds on this introduction. It contains a fairly detailed description of requirements for admission to the securities markets. It discusses market participants, more specifically the laws and regulations regarding the exchanges and brokers and dealers. In addition, it discusses the requirements for securities to be admitted to the securities markets. This sub-section is divided into three parts: listed securities, unlisted securities, and investment undertakings. For these three groups, specific requirements for the securities and the issuers, as well as rules regarding the prospectus and corporate governance are discussed.

The third section discusses the rules for trading. It discusses what is considered an offering, when an offering must be accompanied by a prospectus, and when an offer will be considered to take place in or from The Netherlands. The laws regarding the disclosure of substantial holdings are described. The rules regarding insider trading and fraud and the rules regarding public take-over bids are discussed. The final section briefly discusses approaches to jurisdictional conflicts.

Regulatory System

European Community Directives

Much of the law in the securities area derives from European Community (EC) Directives. Since there is a separate chapter on European law, this aspect will not be further discussed. All applicable EC Directives have been implemented in several Dutch Acts that will be discussed below. However, some Directives have been partly implemented

1 This chapter should not be regarded as legal advice. Due to its scope and length, it inevitably contains generalisations and simplifications.

through self-regulation by the securities exchanges, by regulations of the Securities Board of The Netherlands (*Stichting Toezicht Effectenverkeer*) or the Dutch Central Bank (*De Nederlandsche Bank*), both supervisory bodies in the securities field.

Dutch Laws Regarding Securities

Act on Supervision of Securities Trade 1995. The Act on Supervision of Securities Trade 1995 (*Wet Toezicht Effectenverkeer*) is the main Act regulating the securities industry in The Netherlands. It regulates a number of topics, discussed below. It also is the basis for the powers of the Securities Board of The Netherlands.

Securities Offerings. The Act on Supervision of Securities Trade 1995 regulates all non-private offerings of securities, except for listed securities and securities issued by investment undertakings. In addition, so-called savings certificates (*spaarbewijzen*) are not regulated by the Act on Supervision of Securities Trade 1995.

The general structure of the Act on Supervision of Securities Trade 1995 is that all non-private offerings of securities are prohibited, unless a prospectus is published that complies with the requirements set out in the Act on Supervision of Securities Trade 1995[2] or unless an exception or exemption from these requirements applies. These requirements, exceptions, and exemptions are set out in the Decree on the Supervision of Securities Trade (*Besluit Toezicht Effectenverkeer*), the Further Regulation regarding the Act on Supervision of Securities Trade 1999 (hereinafter 'Further Regulation'), and the Exemption Regulation to the Act on Supervision of Securities Trade 1995 (hereinafter 'Exemption Regulation'). Offerings within a 'closed circle', ie, private offerings, are not regulated by the Act on Supervision of Securities Trade 1995. They are not subject to specific government regulation.

Exchanges. In addition, pursuant to the Act on Supervision of Securities Trade 1995, securities exchanges in The Netherlands must be officially recognised or have obtained an exemption from this requirement by the Minister of Finance. Otherwise, they are prohibited.

Securities Institutions. The Act on the Supervision of Securities Trade 1995 requires all securities institutions (*Effecteninstellingen*) (for a definition, see text, below) to have a licence from the Securities Board of The Netherlands.[3] The requirements that securities institutions must fulfil to obtain a licence have been specified in the Decree on the Supervision of Securities Trade.

Mandatory Investors Compensation Arrangement. The Act on Super-vision of Securities Trade 1995[4] also requires all securities institutions and banks to become part of

2 Act on Supervision of Securities Trade 1995, s 3.
3 Act on Supervision of Securities Trade 1995, s 7.
4 Act on Supervision of Securities Trade 1995, s 28a.

the branch-wide investors compensation arrangement. Such an arrangement became necessary because of Directive 97/9.[5]

Holding More than Five Per Cent of Issued Capital of a Securities Institution. The Act on Supervision of Securities Trade 1995 prohibits holding, acquiring, or enlarging five per cent or more of the issued capital (a so-called 'qualified participation') or votes thereon in a securities institution without a declaration of non-opposition from the Minister, who has delegated this power to the Securities Board of The Netherlands. Excepted are participations that have been approved by the Dutch Central Bank pursuant to the Credit Institutions Act (*Wet Toezicht Kredietwezen*). This topic is not further addressed.

Insider Trading. The Act on Supervision of Securities Trade 1995 also prohibits insider trading (see text, below).

Act on Supervision of Investment Undertakings. The Act on Supervision of Investment Undertakings (*Wet Toezicht Beleggingsinstellingen*) prohibits all offerings of or payments in exchange for shares in an investment undertaking, unless that investment undertaking has been granted a licence by the Dutch Central Bank (*De Nederlandsche Bank*). Offerings and transactions within a 'closed circle' are excepted.

In addition, the Act on Supervision of Investment Undertakings sets forth requirements that need to be fulfilled to obtain a licence. These requirements have been specified in the Decree on the Supervision of Investment Undertakings (*Besluit Toezicht Beleggingsinstellingen*). One of these requirements is that a prospectus regarding the investment undertaking should be made available.

There are a number of exceptions and exemptions to the licence requirement. These have been set out in the Decree on the Supervision of Investment Undertakings and the Exemption Regulation to the Act on Supervision of Investment Undertakings. If the Act on Supervision of Investment Undertakings is applicable, the Act on Supervision of Securities Trade 1995 will not be applicable.

Other Laws Regarding Securities. Several other laws are relevant to the securities industries.

Credit Supervision Act 1992. The Credit Supervision Act 1992 regulates banks and similar institutions. The Credit Supervision Act requires all banks to obtain a licence and arranges for the supervision of all banks by the Dutch Central Bank. Unlicensed persons or entities are prohibited from obtaining money from the public.[6] However, the obtaining of money as consideration for securities issued in accordance with the Act on Supervision of Securities Trade 1995 is exempted from this prohibition.

5 European Community Directive 97/9, 3 March 1997, OJ 1997, L 84/22.
6 Credit Supervision Act, s 82.

Generally, banks that are under Credit Supervision Act supervision are excepted from the supervision of the Securities Board of The Netherlands, and they are exempted from licence requirements for securities institutions of the Act on Supervision of Securities Trade 1995. However, due to agreements between the Dutch Central Bank and the Securities Board of The Netherlands, the Board strictly supervises securities-trade-related activities of banks. The Credit Supervision Act is not further addressed, except in the context of certain exceptions and exemptions from the securities laws proper.

Major Holdings Disclosure Act. Pursuant to the Major Holdings Disclosure Act (*Wet melding zeggenschap in ter beurse genoteerde vennootschappen*), the acquisition of substantial holdings in listed companies must be disclosed.[7]

The purpose of the Major Holdings Disclosure Act is to increase the transparency of the securities market for listed securities. The Major Holdings Disclosure Act, therefore, creates two obligations. First, the investor must disclose certain information about transactions in listed securities to the issuer and to the Securities Board of The Netherlands. Subsequently, the Securities Board of The Netherlands must publish information regarding the transaction in a national publication.[8]

Other Laws. There are specific rules for certain very specific and limited securities and securities services. Thus, the Canvassing Act (*Colportagewet*) contains some rules regarding the canvassing by personal visit only in unlisted securities, of which the price is not otherwise regularly published. The Savings Certificates Act (*Wet inzake Spaarbewijzen*) regulates savings certificates, which are defined as bearer commercial paper representing a nominal claim on the issuer, with no interim interest payments.[9] The Security Depository Act (*Wet Giraal Effectenverkeer*) regulates the keeping and transferral of bearer shares admitted to its system. In practice, all listed securities are deposited pursuant to the Security Depository Act.

The Netherlands Central Institution for Giro Securities Transactions (*Nederlands Centraal Instituut Giraal Effectenverkeer*, NECIGEF) acts as a central depository for bearer shares. All banks maintain accounts with the NECIGEF. Transferral of bearer shares from or to customers if those banks may be done by simple book entry. In addition, there are specific anti-money-laundering laws and specific laws regarding notification and information regarding financial transactions with persons in other countries.

Rules of the Amsterdam Exchanges NV and Socio-Economic Council Merger Code

Rules of the Amsterdam Exchanges NV. For securities transactions related to the Amsterdam Exchanges NV, the Rules of the Amsterdam Exchanges NV are the most

7 The Major Holdings Disclosure Act implements European Community Directive 88/627/EEC, OJ L 348. The Act was substantially revised in 1996.
8 Major Holdings Disclosure Act, ss 2 and 7.
9 Savings Certificates Act, s 1(a).

important source of law. Its regulations are binding out of contract, the Listing Agreement. The most important are:

- The Listing Rules (*Fondsenreglement*);
- The Special Listing Rules NMAX (*Reglement Bijzondere Vereisten Nieuwe Markt Amsterdam*); and
- The Listing Procedure Rules (*Reglement Procedure Beursnotering*).

The most important of these, the Listing Rules, will be revised in the near future, due to changes in the structure of the Amsterdam Exchanges NV, and changes in the law.

Socio-Economic Council Merger Code. The Socio-Economic Council is the foremost advisory body of the government in the field of socio-economic affairs in The Netherlands. It consists of representatives of employers, unions and the government. It has adopted the Merger Code (*Fusiecode*) to further both union involvement in mergers and shareholder protection with regard to public take-over bids.

Legal Sources

European Union Law

There are numerous EC Directives in the securities field, and much of Dutch securities law derives from these Directives. In this respect, EC Directives are an important source of law.

Dutch Laws and Regulations

In General. For most securities problems, the solution will be found in the several securities Acts, their legislative history, and their accompanying regulations. An overview of securities Acts has been given above. Acts often delegate further rule-making to the government. This may be done in several ways. First, the government may issue a General Measure of Administration (*Algemene Maatregel van Bestuur*, AMvB), through a Royal Decree. Second, if the Act or the General Measure of Administration so stipulates, the Minister may issue ministerial regulations.

Finally, much rule-making has been delegated further to the supervisory authorities, the Securities Board of The Netherlands, and the Dutch Central Bank. Therefore, a practitioner may be confronted with an Act, further specified by Royal Decree containing a General Measure of Administration, further specified by ministerial regulations, and further specified by rules of the supervisory authority. These sources of law have been stated in hierarchical order.

Court Cases. There are very few court cases in the securities field. Moreover, formally, there is no *stare decisis* or rule of precedent in The Netherlands. Informally, court cases have strong persuasive value. Of course, the persuasiveness will depend on the place in the hierarchy of the court that decided a case. Thus, decisions of the Supreme Court (*Hoge*

Raad) have the strongest persuasive force. Below these are the Courts of Appeal (*Gerechtshoven*), General Trial Courts (*Arrondissementsrechtbanken*), and Cantonal Courts (*Kantongerechten*). The last mentioned have a limited subject matter jurisdiction and, generally, they are not involved in securities litigation.

Cases of the Securities Dispute Commission. Disputes between private investors and securities institutions admitted to one of the exchanges, may be decided by the Securities Dispute Commission (*Geschillencommissie Beursbedrijf*). The investor may decide to use this alternative means of dispute resolution, or to go to court. The Securities Dispute Commission's judgments are binding on the parties, with the force of a contract between them. Because the procedure is inexpensive, because the Securities Dispute Commission has a good deal of know-how, and because the procedure is not public, it is generally considered preferable to court proceedings.

Opinions of the Securities Dispute Commission are published and carry considerable authority in the field of relations between private investors and brokers/portfolio managers. Generally, courts refer to these opinions, and they will follow their lead. However, the opinions are not law, and there may be differences between court opinions and the opinions of the Securities Dispute Commission.

Authorities

Minister of Finance

In both the Act on Supervision of Securities Trade 1995 and the Act on Supervision of Investment Undertakings, the relevant government entity is the Minister of Finance. However, the Minister of Finance has delegated most of his powers under the Act on Supervision of Securities Trade 1995 and the Act on Supervision of Investment Undertakings to two supervisory authorities, the Securities Board of The Netherlands and the Dutch Central Bank. The Minister is responsible for the adequate supervision of the Securities Board of The Netherlands and Dutch Central Bank. The Minister has retained the power to:

- Create generally applicable exemptions from prospectus requirements;
- Impose periodic disclosure requirements;
- Establish licence requirements to engage in securities services;
- Require approval for acquiring a larger stake than five per cent in a securities institution; and
- Establish recognition and exemption requirements for exchanges.

In addition, the Minister has retained a number of the powers regarding securities exchanges.

Securities Board of The Netherlands

In General. The Securities Board of The Netherlands is a private law foundation, of which the board members are appointed by the Minister of Finance. Pursuant to section 40

of the Act on Supervision of Securities Trade 1995, the Minister of Finance has delegated most of his powers under the Act to the Securities Board of The Netherlands. Thus, for example, the Securities Board of The Netherlands makes rules regarding the structure of a prospectus and determines whether an exemption from the prospectus requirement applies. The Securities Board of The Netherlands also grants licences to securities institutions.

The Securities Board of The Netherlands has been delegated the power to hear appeals against refusals to list or decisions to de-list securities by the Amsterdam Exchanges NV.[10] In addition, the Securities Board of The Netherlands has been delegated the powers of the Minister of Finance under the Major Holdings Disclosure Act.

Powers to Obtain Information. Pursuant to section 29 of the Act on Supervision of Securities Trade 1995, the Securities Board of The Netherlands has the power to demand the information reasonably necessary for its supervisory activities from issuers, securities institutions, exchanges, and persons having more than five per cent of the shares of a securities institution.

Moreover, employees of the Securities Board of The Netherlands have the right to enter all places if necessary, view business documents, and make copies of these documents. All persons are required to co-operate.[11] This also applies to foreign issuers and securities institutions when securities transactions in The Netherlands are concerned.

Power to Give Directions. The Securities Board of The Netherlands has the power to give directions to persons and entities, within the purview of the Act on Supervision of Securities Trade 1995, if they do not comply with the law.[12] The Securities Board of The Netherlands also may publish a warning with regard to certain persons or entities.[13]

In the event that directions by the Securities Board of The Netherlands are not complied with, the Securities Board may notify the securities institution in writing that any or all of its organs and officers may only exercise their powers after obtaining approval from the Securities Board of the Netherlands. Persons who do not comply with this arrangement are personally liable to the securities institution for acts done without permission of the Securities Board of The Netherlands.

The Securities Board of the Netherlands also may publish the direction given, as well as any correspondence between the Securities Board of the Netherlands and the securities institution.[14] The securities institution may nullify transactions concluded in violation of these directions if the third party knew of the measure. The maximum duration of this situation is one year.

10 Act on Supervision of Securities Trade 1995, s 43.
11 Act on Supervision of Securities Trade 1995, s 29.
12 Act on Supervision of Securities Trade 1995, s 28.
13 Act on Supervision of Securities Trade 1995, s 32.
14 Act on Supervision of Securities Trade 1995, s 28.

Confidentiality. The Securities Board of The Netherlands and its employees are under a duty to keep all information they obtain secret,[15] unless one of the following situations occurs. The Securities Board of The Netherlands may divulge information when:

- Its employees are called as witnesses or experts in criminal proceedings; or
- A securities institution has been declared bankrupt or has been dissolved, in civil proceedings.[16]

Additionally, the Securities Board of The Netherlands may give information to the Amsterdam Exchanges NV.[17] Finally, the Securities Board of The Netherlands is under a limited obligation to inform the Minister of Finance.[18] Pursuant to section 31(5) of the Act on Supervision of Securities Trade 1995, the Securities Board of The Netherlands will not need to provide information that may be traced to specific corporations or institutions.[19]

Co-Operation with Other Supervisory Authorities. The Securities Board of The Netherlands co-operates and exchanges information with other supervisory authorities in The Netherlands, like the Dutch Central Bank.[20] More importantly, in the context of international transactions, the Securities Board of The Netherlands may give information to foreign governments and foreign supervisory authorities charged with the supervision of financial markets. There are limitations on this power, such as when:

- The foreign request is too vague;
- Compliance would violate Dutch law or public order; or
- It is not certain that the information will solely be used for the purposes stated by the foreign authority.[21]

In addition, the Securities Board of The Netherlands co-operates with supervisory authorities of other EU and European Economic Area (EEA) countries.[22] Likewise, the Securities Board of The Netherlands co-operates with the American and British authorities, pursuant to treaties between these countries and The Netherlands. The Securities Board of The Netherlands has the power to gather information at the request of the foreign authority. A representative of the foreign authority may take part in these investigations.[23] Persons asked for information must provide it, must co-operate, and must give access to all business papers.[24] The co-operation with other EU and EEA supervisory authorities entails

15 Act on Supervision of Securities Trade 1995, s 31.
16 Act on Supervision of Securities Trade 1995, ss 31 and 33a.
17 Act on Supervision of Securities Trade 1995, s 31(6).
18 Delegation Decree, s 8(5).
19 There is legislation pending that will give the Minister of Finance wider powers to obtain information, although these will still be limited.
20 Act on Supervision of Securities Trade 1995, s 34.
21 Act on Supervision of Securities Trade 1995, s 33.
22 Act on Supervision of Securities Trade 1995, s 35.
23 Act on Supervision of Securities Trade 1995, s 37.
24 Act on Supervision of Securities Trade 1995, s 36.

the giving of information as described above, but it also includes powers to ask for verification of information or to verify the information itself.[25]

The Securities Board of The Netherlands may enter into written agreements with foreign authorities, even ones that do not have a treaty with The Netherlands, pursuant to section 33 of the Act on Supervision of Securities Trade 1995, but these agreements must be approved by the Minister of Finance.

Competent Authority for European Community Directives. In addition, the Securities Board of The Netherlands is the 'competent authority' for purposes of the Public Offer Prospectus Directive,[26] the Capital Adequacy Directive,[27] and the Investment Services Directive.[28] However, with regard to banks (*kredietinstellingen*) and with regard to investment undertakings, the Dutch Central Bank is the competent authority pursuant to these Directives.[29]

Dutch Central Bank

The Dutch Central Bank is the supervisory authority both for credit institutions and for investment undertakings. The Minister of Finance has delegated all of his powers under the Act on Supervision of Investment Undertakings to the Dutch Central Bank, pursuant to section 29 of the Act,[30] with two conditions, namely:

- Written agreements with foreign supervisory authorities must be approved by the Minister; and
- The Dutch Central Bank has a duty to consult the Securities Board of The Netherlands when the Dutch Central Bank exempts investment undertakings from certain requirements when they are listed on certain exchanges.

What has been said above for the Securities Board of The Netherlands with regard to powers to obtain information, to give information, confidentiality, co-operation with other and foreign supervisory authorities, and binding directions to those institutions that it supervises also applies to the Dutch Central Bank, although it is based on different sections of the Act on Supervision of Investment Undertakings.[31]

In case of special circumstances that threaten the functioning of an investment undertaking, the Dutch Central Bank may decide that any or all organs and officers of the investment undertaking may only exercise their powers after obtaining approval or

25 Act on Supervision of Securities Trade 1995, ss 38 and 39.
26 European Community Directive 89/298/EEC, OJ L 124.
27 European Community Directive 93/6/EEC, OJ L 141.
28 European Community Directive 93/22/EEC, OJ L 141.
29 Regulation for Appointment of the Competent Authority Act on Supervision of Securities Trade 1995 (*Regeling aanwijzing bevoegde autoriteiten Wet Toezicht Effectenverkeer*) 1995, s 6, 21 December 1995, *Staatscourant* 1996, at p 251.
30 Delegation Decree of 14 August 1990, *Staatsblad* (1990), at p 458.
31 Act on Supervision of Investment Undertakings, ss 24–27c.

instructions from the Dutch Central Bank. It must notify the investment undertaking in writing of this decision.[32] Those persons who do not comply with the directions of the Dutch Central Bank in such a case are personally liable for damages to the investment undertaking.

In addition, the investment undertaking may nullify transactions concluded in violation of these directions if the third party knew of the measure.[33] The maximum duration of this situation is one year.[34]

Amsterdam Exchanges NV

As of 1 January 1997, all recognised exchanges in The Netherlands are owned by the Amsterdam Exchanges NV. The officially recognised exchanges are:

- Amsterdam Exchanges NV Stock Exchange (*Amsterdam Exchanges NV-Effectenbeurs*);
- Amsterdam Exchanges NV Options Exchange;
- Amsterdam Exchanges NV Financial Futures Exchange (*Amsterdam Exchanges NV-Financiele Termijn Markt*); and
- Amsterdam Exchanges NV Commodities Futures Exchange (*Amsterdam Exchanges NV-Agrarische Termijnmarkt*).

The Amsterdam Exchanges NV Stock Exchange consists of two separate markets, namely:

- The Official Market; and
- The NMAX, a market specifically for young, growing enterprises.

In addition to keeping the only recognised stock exchanges in The Netherlands, the Amsterdam Exchanges NV is the competent authority for purposes of the Stock Exchange Admission Directive,[35] the Listing Particulars Directive,[36] and the Periodical Disclosure for Listed Securities Directive.[37] The Amsterdam Exchanges NV is mandated to bring about co-operation with foreign exchanges pursuant to these Directives.[38]

Procedures under Act on Supervision of Securities Trade 1995 and Act on Supervision of Investment Undertakings

Decisions by, and the decision-making procedure of, governmental entities like the Securities Board of The Netherlands and the Dutch Central Bank are governed by the General

32 Act on Supervision of Investment Undertakings, s 22(1).
33 Act on Supervision of Investment Undertakings, s 22(2)(d).
34 Act on Supervision of Investment Undertakings, s 22(2)(e).
35 European Community Directive 79/279/EEC, OJ L 66, as amended.
36 European Community Directive 80/390/EEC, OJ L 100, as amended.
37 European Community Directive 82/121/EEC, OJ L 48.
38 Regulation for the appointment of the Competent Authority Act on Supervision of Securities Trade (*Regeling aanwijzing bevoegde autoriteiten Wet Toezicht Effectenverkeer*) 1995, ss 3 and 4, 21 December 1995, *Staatscourant* (1996), at p 251.

Administrative Law Act (*Algemene Wet Bestuursrecht*). Appeal against decisions by the Minister of Finance, the Securities Board of The Netherlands, and the Dutch Central Bank under the Act on Supervision of Securities Trade 1995 and the Act on Supervision of Investment Undertakings is possible. Such appeals must be lodged with the Business Appeals Board (*College van Beroep van Bedrijfsleven*), which is the highest court for many business administrative law affairs. The procedural rules for these appeals are set out in the General Administrative Law Act and the Administrative Adjudication Business Organisations Act (*Wet bestuursrechtspraak Bedrijfsorganisatie*).

However, a refusal by the Amsterdam Exchanges NV to list certain securities or a decision to de-list certain securities from the Exchanges, unless this decision was made to implement a Directive from the Minister of Finance, must first be appealed to the Minister of Finance, who has delegated this power to the Securities Board of The Netherlands.[39]

Admission

Market Participants

Exchanges

The Act on Supervision of Securities Trade 1995 prohibits the maintenance of a securities exchange without recognition as an official exchange by the Minister of Finance.[40] An 'exchange' is defined in section 1(e) of the Act on the Supervision of Securities Trade 1995 as 'a regulated market meant to connect supply and demand in securities'. Official recognition can only be obtained when the exchange is maintained in The Netherlands, and the exchange meets certain, unfortunately unspecified, requirements regarding the reliability and expertise of its directors, the financial guarantees of the exchange, the clearing and settlement systems, and the powers of the exchange to compel its members to comply with the law and exchange regulations. The Minister of Finance can impose conditions and restrictions on his recognition.[41]

However, no recognition is needed by exchanges already licensed in another member state of the EU or EEA, under the conditions and procedures as set out in the Investment Services Directive.[42] Note, however, that the definitions of securities in the Act on Supervision of Securities Trade 1995 and the Investment Services Directive are not the same. Therefore, the exception for EU and EEA exchanges will not apply to exchanges that trade in securities considered securities under the Act on Supervision of Securities Trade 1995, but are not considered securities under the Investment Services Directive. Most notably, commodity futures are not considered securities by the Investment Services Directive, whereas they are securities under the Act on Supervision of Securities Trade 1995. The exception for exchanges from EU and EEA countries of section 22(4) of the

39 Act on Supervision of Securities Trade 1995, s 43. After that, an appeal may be lodged with the Administrative Adjudication Business Organisations Act.
40 Act on Supervision of Securities Trade 1995, s 22(1).
41 Act on Supervision of Securities Trade 1995, s 22(2) and (3).
42 European Community Directive 93/22/EEC, OJ L 141.

Act on Supervision of Securities Trade 1995, therefore, does not apply to exchanges that trade in those commodities futures.

The exception is conditioned on the foreign exchange's compliance with the rules necessary for the adequate functioning of the exchanges or the protection of investors using the exchanges.[43] In addition, the Minister may grant an exemption of the recognition requirement to any other exchange, with conditions and restrictions, if he wishes.[44] Such an exemption means the prohibition of section 22 of the Act on Supervision of Securities Trade 1995 does not apply; yet, this does not mean that the exchange is 'officially recognised'. Therefore, the exemption of the prospectus requirement for listed securities may not apply to such an exempted exchange.

Recognised exchanges must notify the Securities Board of The Netherlands in advance of any changes in their rules and regulations and must ensure that the rules and regulations can be enforced against institutions admitted to their exchanges.[45] In addition, the Securities Board of The Netherlands can give directions to the officially recognised exchanges.[46]

Securities Institutions

In General. Securities institutions are:

- Brokers (*effectenbemiddelaars*);
- Dealers, underwriters, and brokers regarding interest swaps, currency swaps, securities swaps, or comparable derivatives; and
- Portfolio managers (*vermogensbeheerders*).[47]

Licence. Each securities institution, whether or not it is admitted to a recognised exchange, needs a Securities Board of The Netherlands licence if it provides these services in or from The Netherlands. Therefore, a licence is required for securities services regarding transactions on the recognised exchanges, as well as for 'off-market' transactions and transactions through transborder electronic trading systems.[48] The licence is not required if an exception or an exemption applies.

Exceptions to Licence Requirement. The following securities institutions do not need a licence:

- Securities institutions which are already under the supervision of a supervisory authority pursuant to some other Dutch law than the Act on Supervision of Securities Trade

43 Act on Supervision of Securities Trade 1995, s 22(3) and (4).
44 Act on Supervision of Securities Trade 1995, s 25.
45 Act on Supervision of Securities Trade 1995, s 24(1) and (2).
46 Act on Supervision of Securities Trade 1995, s 24(3) and (4).
47 Act on Supervision of Securities Trade 1995, s 1.
48 Act on Supervision of Securities Trade 1995, s 7.

1995 (eg, insurance companies and banks registered under the Credit Supervision Act that have received permission to provide securities services);
- Central banks or comparable institutions of other EU or EEA member states;[49]
- Foreign securities institutions which have a so-called European passport (see text, below);[50]
- Institutions which perform their activities exclusively for affiliated companies or exclusively perform portfolio management activities regarding participation plans of employees;[51]
- Institutions which only incidentally perform securities services in connection with their profession (eg, civil law notaries, attorneys-at-law, and accountants);[52] and
- Persons whose main business is trading in raw materials with either professional users of these materials or with others who engage in the same trade and who perform securities services only with these parties and to the extent that their business so requires.[53]

European Passport. Securities institutions do not need a licence if they:

- Are domiciled in an EU or EEA member state;
- Hold a licence issued by the competent authority of their home country; and
- Have fulfilled the so-called 'notification proceeding' and, therefore, possess a 'European passport'.[54]

The supervisory authority of the home country supervises these institutions with regard to compliance with business and economic requirements. The notification proceeding differs, depending on whether the securities institution will provide its services in The Netherlands through a branch office in The Netherlands or will provide the services from the home country. In the first case, the Securities Board of The Netherlands must have received a notification of the supervisory authority of the home country, indicating:

- The intended activities;
- The organisational structure of the institution;
- The address of the branch office; and
- The identity of the persons responsible for the daily operation of the branch office.[55]

In the second case, a notification by the securities institution to the supervisory authority of its home country regarding the intended activities in The Netherlands is sufficient.[56] The supervisory authority of the home country will then inform the Securities Board of The Netherlands.

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49 Act on Supervision of Securities Trade 1995, s 7(2)(e).
50 Act on Supervision of Securities Trade 1995, s 7(2)(i) and (j).
51 Act on Supervision of Securities Trade 1995, s 7(2)(b), (c), and (d).
52 Explanatory Memorandum to the Act on Supervision of Securities Trade 1995.
53 Act on Supervision of Securities Trade 1995, s 7(2)(g).
54 Act on Supervision of Securities Trade 1995, s 7(2)(i) and (j).
55 Act on Supervision of Securities Trade 1995, s 7(2)(i).
56 Act on Supervision of Securities Trade 1995, s 7(2)(j).

However, according to a decision of the Minister of Finance,[57] securities institutions domiciled in EU and EEA countries that have not completely implemented the Investment Services Directive or the Capital Adequacy Directive cannot use this exception. According to the Securities Board of The Netherlands, the United Kingdom, Ireland, Sweden, Denmark, Belgium, Finland and France have completely implemented the Directives.[58]

Exemptions from the Licence Requirement. The Act on Supervision of Securities Trade 1995 provides for exemptions from the licence requirement that can be distinguished in exemptions:

- Not related to the type of securities for which services are provided; and
- Only for services in one or more types of securities.

The exemptions unrelated to the type of securities are:

- The exemption for branch pension funds, company pension funds, and company saving funds under the supervision of the Insurance Supervisory Authority (*Verzekeringskamer*) that only provide securities services for the branch or company concerned;[59]
- The so-called 'family' companies (ie, Dutch corporations whose shareholders can only be a closed circle of family members), which only provide securities services for members of that closed circle;[60] and
- Persons or legal entities (*cliënten-remisiers*) that, when offering or performing securities services, only introduce clients to other securities institutions or investment undertakings.[61]

The exemptions for services in one or more types of securities are:

- Persons or legal entities (*order-remisiers*) that, as portfolio managers, bring orders in securities to which the Investment Services Directive does not apply (eg, commodity futures) or orders in transferable securities or units in collective investment for the account of clients to securities institutions that are admitted to a recognised exchange;[62]
- Securities institutions providing services for professional market parties as far as securities are involved to which the Investment Services Directive does not apply;[63] and
- Recognised 'private participation companies', as far as they provide services as a broker only regarding their own shares.[64]

57 Decree of 21 December 1995, s 1, *Staatscourant* (27 December 1995).
58 *Staatscourant* (29 February 1996, 26 April 1996, and 24 January 1997).
59 Exemption Regulation Act on Supervision of Securities Trade 1995, s 16.
60 Exemption Regulation Act on Supervision of Securities Trade 1995, s 12.
61 Exemption Regulation Act on Supervision of Securities Trade 1995, s 12.
62 Exemption Regulation Act on Supervision of Securities Trade, s 13.
63 Exemption Regulation Act on Supervision of Securities Trade 1995, s 14.
64 Exemption Regulation Act on Supervision of Securities Trade 1995, s 15. Private participation firms are companies that provide venture capital. In the context of stimulating commerce and enterprise in The Netherlands, these private participation firms may be guaranteed by the state (and thereby may be officially recognised), if they meet certain criteria.

The above exemptions may be subject to certain conditions, such as a notification to the Securities Board of The Netherlands and observance of the rules of the exchange concerned.

Requirements to Obtain a Licence. If a licence is required, the securities institution must apply for one with the Securities Board of The Netherlands. To receive a licence, the securities institution must fulfil requirements[65] regarding:

- Expertise and reliability — The required expertise depends on the precise activities of the securities institution. The reliability concerns, among others, whether the management of the securities institution has a criminal record.[66]
- Capital adequacy — The securities institution must have a minimum equity capital of, depending on the activities of the securities institution, between €35,000 and €730,000.[67]
- Management and establishment of head office — There are requirements concerning (a) the structure of the organisation, (b) separation between the assets of the securities institution and its clients, and (c) organisation and internal control. The structure of the organisation must safeguard that conflicts of interest among clients and between the securities institution and clients are avoided.[68] To protect the ownership rights of clients, the securities institution must separate the assets of clients from the assets of the securities institution itself.[69] Generally, this is done by depositing the money and securities of the clients with a third party that is a recognised credit institution, if the securities institution is not itself such a recognised credit institution. The security institution should organise its administration in such a way that the Securities Board of The Netherlands is able to supervise whether the rules regarding operational management and capital adequacy are observed.[70] The daily management of the securities institution must be determined by at least two persons.[71] The head office of the securities institution must be in the country of establishment. The head office is deemed the place of domicile of the persons who determine the daily management.[72]
- Safeguards for and adequate supervision of observance of the rules — The structure of the group of which a securities institution is a part must be such that the Securities Board of The Netherlands can adequately supervise the securities institution. A 'group'

65 Act on Supervision of Securities Trade 1995, s 7(4).
66 *Kamerstukken* II (1988–1989), Number 21038, no 6, at pp 27 and 28. From 1 January 1999, the reliability of the daily management must be beyond doubt. In other words, the Securities Board of The Netherlands has more discretion than it once had in judging applicants.
67 Further Regulation Act on Supervision of Securities Trade 1995, s 4.
68 Decree on the Supervision of Securities Trade, s 15; Further Regulation Act on Supervision of Securities Trade 1995, ss 13–17.
69 Decree on the Supervision of Securities Trade, s 16; Further Regulation Act on Supervision of Securities Trade 1995, s 18.
70 Decree on the Supervision of Securities Trade 1995, s 17; Further Regulation Act on Supervision of Securities Trade 1995, s 19.
71 Decree on the Supervision of Securities Trade, s 14.
72 Decree on the Supervision of Securities Trade, s 18(1)(1), and the Explanatory Memorandum.

also includes private persons who are shareholders of the securities institution and (non-consolidated) participations.[73]

Less Stringent Licence Regime for Certain Foreign Securities Institutions. Some securities institutions domiciled in non-EU and non-EEA countries are governed by a less-stringent licence regime.[74] The less-stringent regime concerns securities institutions that:

- Are domiciled outside the EU and EEA (and, therefore, cannot obtain a European passport);
- Will provide, or have provided, securities services in The Netherlands to professional investors without having a branch office in The Netherlands; and
- Are under supervision in their home country that is comparable, in the opinion of the Securities Board of The Netherlands, to the supervision in The Netherlands.[75]

Securities institutions under the less stringent regime are not obliged to fulfil the requirements regarding expertise and reliability, capital adequacy, (operational) management, management personnel, and establishment of the head office. Nor are they required to provide all the information and documents in connection with the application for a licence (see text, below). However, such securities institutions must comply with the applicable rules to conducting transactions in general (see text, below). The Securities Board of The Netherlands is entitled to restrict the licence and to prescribe certain conditions.

Licence Application Procedure. Until 1 January 1999, there was a difference in the application procedure for securities institutions to be admitted to an officially recognised exchange and other securities institutions. From 1 January 1999, all securities institutions must apply for a licence directly with the Securities Board of The Netherlands.

There is legislation pending that will grant the Securities Board of The Netherlands and the Dutch Central Bank the power to fine securities institutions and issuers that do not comply with relevant legislation and regulations. In addition, the Securities Board of The Netherlands will obtain the power to impose *dwangsommen*, ie, fines that increase per violation or per day a violation exists. It is as yet unknown whether and when this proposal will become law.

In order to apply for a licence, specific information and documents must be provided to the Securities Board of The Netherlands regarding:

- The management and the shareholders;
- The organisational structure;

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73 Act on Supervision of Securities Trade 1995, s 7(4)(e); Decree on the Supervision of Securities Trade, s 18(a). However, even if these requirements are not met, a licence may be granted if the requirements cannot reasonably be fulfilled and the purposes of the Act on Supervision of Securities Trade 1995 can be achieved otherwise.

74 Letter of the Securities Board of The Netherlands, 5 July 1996.

75 The Securities Board of The Netherlands presently only acknowledges the United States as a country where the supervision (by the Securities Exchange Commission and the Commodities, Futures, and Trading Commission) is comparable to the supervision in The Netherlands.

- The system of separation of assets;
- The internal control system;
- The general conditions which apply to agreements with clients; and
- The types of securities to which the services apply.

In addition, a description of the services to be provided and a statement of an accountant about the fulfilment of the capital adequacy requirement must accompany the application.[76]

Admission to Recognised Exchanges

Those securities institutions that wish to become active on an exchange must, after obtaining a licence from the Securities Board of The Netherlands, apply for admission to the relevant exchange. In respect of requirements for admission, each of the four recognised exchanges has its own requirements. These requirements differ, depending on the activities and capacity of the securities institution on the relevant exchange.

Applications for admittance to the Amsterdam Exchanges NV Stock Exchange, Amsterdam Exchanges NV Options Exchange, and the Financial Futures Exchange must be filed with the Amsterdam Exchanges NV. Applications for admittance to the Commodities Futures Exchange must be filed with the Amsterdam Exchanges NV Commodities Futures Exchange (*Agrarische Termijnmarkt*).

The securities institution that wishes to be admitted to one of the exchanges must provide the Amsterdam Exchanges NV or Commodities Futures Exchange with documents and information comparable to those to be provided to the Securities Board of The Netherlands by institutions that apply for the off-market licence. Furthermore, the applicant must pay an entrance fee. In addition, several annual fees must be paid to the exchanges, depending on the function of the securities institution with the exchange concerned.[77]

Conditions for Activities as Securities Institution

In General. Licence holders must:

- Comply with the requirements of the licence;[78]
- Comply with rules of conduct;[79]

76 Act on Supervision of Securities Trade 1995, s 20.

77 Amsterdam Exchanges NV General Regulation, Appendix I; Commodities Futures Exchange General Regulation, Appendix I.

78 Changes in organisation, structure, and management require the approval of the Securities Board of The Netherlands. Decree on the Supervision of Securities Trade, s 22.

79 The rules of conduct are rules regarding the relationship with the client, such as providing certain information to the clients and the manner in which complaints of the clients will be treated. Decree on the Supervision of Securities Trade, s 24; Further Regulation Act on Supervision of Securities Trade 1995, s 8; Commodities Futures Exchange General Regulation, Appendix I.

- Conclude an agreement with the client in accordance with legal requirements, eg, a description of services, costs, manner of administration, and liabilities must be included;[80]
- Provide a statement to the client in accordance with certain requirements;[81]
- In the case of portfolio management, provide a statement regarding the composition and value and costs of the portfolio;[82]
- Inform the client about any applicable regulation regarding guarantees;[83]
- Comply with general administrative and depository obligations, as well as keep records of transactions during a certain period;[84]
- Take part in the mandatory investor compensation scheme which, in case of bankruptcy, provides a limited compensation of up to €20,000; and
- Comply with the rules regarding the content of advertisements.

In addition, securities institutions may not engage in misleading actions and/or manipulate the prices of securities. Exemption from this prohibition is the stabilisation of prices of newly listed securities, as long as such stabilisation meets a number of requirements listed in the regulations.

In addition, the accountant who audits the annual accounts has a duty to inform the Securities Board of The Netherlands of information contrary to the obligations of the securities institution under the licence or the obligations under the Act on Supervision of Securities Trade 1995.[85]

Rules for Securities Institutions Excepted from Licence Requirement. Credit and financial institutions that have a licence from the Dutch Central Bank or are already supervised by the Dutch Central Bank pursuant to the Credit Supervision Act, or credit and financial institutions that are domiciled in an EU or EEA member state, and may provide securities services pursuant to their licence issued by the supervisory authority in their home country, only need to comply with some of the rules described above.

Institutions that have a licence from the Dutch Central Bank or are already supervised by the Dutch Central Bank pursuant to the Credit Supervision Act must comply with the rules of conduct, the obligation to conclude a client agreement and, if they provide asset management, provide a statement regarding the composition, value, and costs of the portfolio. In addition, they must comply with the obligation to provide information relating to

80 Decree on the Supervision of Securities Trade, s 25. A client agreement is not required if the services of the securities institution are limited to the execution of explicit instructions on the client's initiative and in the case of inter-professional trade; see Decree on the Supervision of Securities Trade, s 26(1) and (2).
81 Decree on the Supervision of Securities Trade, s 28; Further Regulation Act on Supervision of Securities Trade 1995, s 38.
82 Decree on the Supervision of Securities Trade, s 29.
83 Decree on the Supervision of Securities Trade, s 27.
84 Civil Code, Book 2, s 10, and Book 3, s 15a; Decree on the Supervision of Securities Trade, s 32.
85 Act on Supervision of Securities Trade 1995, s 11(a)(3)–(6).

applicable guarantee regulations, provide a proper statement, and comply with depository and administrative obligations.[86] Furthermore, the rules regarding (operational) management apply.

Institutions that are domiciled in an EU or EEA member state, and which may provide securities services pursuant to their licence issued by the supervisory authority in their home country, must comply with the rules of conduct and the obligation to conclude a client agreement, provide a proper statement and, if they offer portfolio management, provide a statement regarding composition, value, and costs of the portfolio.[87]

Securities

Securities Listed or to Be Listed on Officially Recognised Exchange

In General. This sub-section discusses the requirements for securities to be admitted to the Amsterdam Exchanges NV markets. Discussed are the requirements for the issuers, for the securities themselves, prospectus and due diligence requirements, and rules regarding corporate governance. This sub-section does not deal with requirements for admission of options and other derivatives, due to the fact that these are 'issued' by the exchanges themselves and, therefore, are not subject to much specific regulation.

Issuer Requirements. Regardless of the type of security (eg, shares or bonds) for which an issuer seeks admission to the Official Market of the Amsterdam Exchanges NV, the issuer will have to fulfil the following requirements:

- The capital of the issuing company must be at least NLG 10 million (after IPO);
- At least three of the last five book years must have been profitable (net profits); and
- During a period of at least five years prior to admission, the issuer must have proven its viability or have had a considerable market share (although this requirement may be waived for 'spin-offs').[88]

Investment undertakings also must have a licence under the Act on Supervision of Investment Undertakings. If the investment undertaking loses its licence, its securities will be de-listed, once the revocation of the licence is final (ie, no longer subject to appeal).[89]

However, Amsterdam Exchanges NV can waive compliance with the second requirement in special cases where the issuer has had at least one net profitable book year out of three previous to its admission and where the existing shareholders agree to a lock up, either not to alienate their shares until at least three book years out of five have been net profitable or not to alienate more than 20 per cent of their shares per year during five years following the year of listing on the Official Market. Amsterdam Exchanges NV may waive the

86 Decree on the Supervision of Securities Trade, ss 27–42.
87 Decree on the Supervision of Securities Trade, ss 35–39, 43, and 44.
88 Amsterdam Exchanges NV Listing Rules, Appendix I, s 7.
89 Amsterdam Exchanges NV Listing Rules and Circular R96-016 (25 September 1996).

above requirements if a governmental entity issues the shares or if a government entity or a company that does meet all requirements guarantees the obligations of the issuer. Due to increasing competition from other exchanges, especially with regard to securitisations, Amsterdam Exchanges NV is discussing new admission requirements with the Securities Board of The Netherlands. To make its admission criteria less stringent, Amsterdam Exchanges NV proposes that the Official Market drop the profit requirement for issuers with a capital of Dfl 100 million after IPO. Additional lock-up requirements and requirements with regard to the risk chapter of the prospectus would probably be imposed in such a case. In addition, instead of a track record of five years, a track record of three years may become sufficient if certain information is available. Amsterdam Exchanges NV has requested the Securities Board of The Netherlands to be allowed to grant dispensation from the current requirements.

To be listed on the NMAX, an issuer will have to fulfil the following requirements:

- The capital of the issuer must be at least €1 million (after IPO);[90]
- The issuer must have deposited its annual statements with the trade registry or must have published its annual statements according to law for at least three complete book years previous to its request for admission to the NMAX;[91]
- The shareholders that own five per cent or more of the shares or depository receipts for shares of the issuer must agree in writing to one of the following 'lock up' provisions: (a) if the issuer at the time of its admission has not yet published an annual statement that shows a positive result on its ordinary business activities after tax, as well as a net profit during a full book year, (i) the shareholders may not alienate any shares or depository receipts for shares until the annual statement of the issuer shows such a result, and (ii) once this condition has been fulfilled, they may not alienate more than 50 per cent of their shares or depository receipts for shares until the annual statements of the issuer show a positive result on ordinary business activities after tax as well as a net profit during the full book year for three years, within a period of five book years, and (b) if the issuer at the time of its admission has published annual statements that show a positive result on its ordinary business activities after tax as well as a net profit during one or two full book years, the shareholders may not alienate more than 50 per cent of their shares or depository receipts for shares until the annual statements of the issuer show such a result for three years, within a period of five book years;[92] and
- The issuer may not be an investment undertaking subject to the Act on Supervision of Investment Undertakings.

However, the Amsterdam Exchanges NV can waive compliance with the requirement relating to deposit or publication of annual statements if the interest of the issuer or the investors so requires and if the Amsterdam Exchanges NV is convinced that investors

90 NMAX Special Listing Rules, s 3(1).
91 Contrary to the requirements of the Official Market, there is no profit requirement imposed in respect of the NMAX.
92 NMAX Special Listing Rules, s 4.

have all the necessary information to form a well-founded opinion about both the issuer and the securities for which admission to the NMAX is sought. This will be the case, although waivers need not be limited to this situation, when the prospectus contains a quantitative forecast of performance of the issuer for the period up to and including the third full book year, counting from the year of the issuance. In addition, all the existing shareholders must have undertaken not to alienate:

- Shares or depository receipts for shares of the issuer until the end of the third full book year;
- Shares or depository receipts for shares until the fourth or any later full book year has shown a positive result on normal business activities after tax as well as a net profit; and
- More than 50 per cent of their respective total amount of shares or depository receipts for shares until the annual financial statements of three full book years have shown a positive result on normal business activities after tax, as well as a net profit, within a period of five years.

The Amsterdam Exchanges NV proposes to change the requirements for the NMAX, in the context of harmonisation of the requirements for all Euro new markets. Capital of an issuer would have to be €1.5 million before offering on the NMAX. The size of the offering would have to be at least €5 million, which would have to be at least 20 per cent of total outstanding capital. At least 100,000 units of securities would have to be offered. In addition, the lock-up rules would change. Existing shareholders could either agree to a total lock up for six months or to a lock-up which would only allow them to alienate 20 per cent of their holding in a year.[93]

Securities Requirements. To be listed, the securities will have to be securities within the definition of the Listing Rules of the Amsterdam Exchanges NV. Section 1 of the Listing Rules, which applies both to the Official Market and to the NMAX, defines securities as follows:

> Securities: shares, bonds (including bonds continuously issued, such as pledges, bank notes, and savings notes and savings certificates), convertible bonds, warrants, participation certificates, claims, scrips, and certificates that give a right to the payment of other securities (such as dividend certificates appointed for stock dividends), as well as certificates and depository receipts and everything else that is generally considered a security in the country where the issuer is located, respectively in The Netherlands.

It is difficult to conceive of a security that will not be considered a security by the Amsterdam Exchanges NV. However, not admissible are depository receipts for shares that cannot be converted to ordinary shares (*niet royeerbare certificaten*).[94]

93 *Het Financiele Dagblad* (23 April 1998), at pp 13 and 21; Press Release 98-057 (22 April 1998) of Amsterdam Exchanges NV.

94 Amsterdam Exchanges NV Listing Rules, Appendix X, s 5.

There are requirements with regard to the size of the first time introduction of the securities on the Amsterdam Exchanges NV Official Market. A total market value of at least NLG 10 million, or its foreign currency equivalent, of the securities must be effectively available for trading. The amount available for trading must correspond with at least 10 per cent of the outstanding capital of the issuer. In addition, the nominal amount of the total offering must be at least 2,000 times the size of the smallest available denomination of offered securities. For offerings of more than NLG 50 million, the nominal amount of the total offering must be at least 10,000 times the smallest available denomination of offered securities. In other words, at least 2,000 units of tradable securities, respectively 10,000 units, must be available for trading.[95] However, the Amsterdam Exchanges NV can waive compliance with these requirements if it expects that sufficient demand for the offered securities will develop.[96]

There are specific rules for the NMAX. There are two kinds of securities that cannot be listed on the NMAX, namely:

- Non-convertible bonds; and
- Securities issued by investment undertakings, as defined in the Act on Supervision of Investment Undertakings.

In addition, the total market value of a first-time offering of securities on the NMAX must be at least €1 million, effectively available for trading.

Prospectus Requirements and Due Diligence Requirements. For securities listed, or shortly to be listed, on Amsterdam Exchanges NV, the rules and regulations of Amsterdam Exchanges NV, and not the Act on Supervision of Securities Trade 1995, determine whether a prospectus must be published, in what way publication must take place, and what requirements the prospectus must fulfil.

General Procedure and Due Diligence. An issuer that wants to be listed on the Official Market or the NMAX must sign a Listing Agreement (*Noterings- overeenkomst*), publish a prospectus according to the requirements of the Listing Rules,[97] and be guided by a securities institution admitted to the exchange that meets certain requirements, the so-called 'sponsor' (almost always a bank). The sponsor has an obligation for three years after the introduction on the exchange to advise the issuer and coach and ensure communication between the issuer and Amsterdam Exchanges NV. A prospectus must be published both for new listings and for offerings of securities that are already listed.[98] Prior approval by Amsterdam Exchanges NV of a prospectus is required.[99]

95 Amsterdam Exchanges NV, Circular R93-03 (S03-081) (25 October 1993).
96 Amsterdam Exchanges NV Listing Rules, s 6(5).
97 Amsterdam Exchanges NV Listing Rules, s 8.
98 Amsterdam Exchanges NV Listing Rules, s 8.
99 Amsterdam Exchanges NV Listing Rules, s 20(1).

The sponsor has the obligation to perform a due diligence investigation to ensure the accuracy and completeness of the information contained in the prospectus.[100] There are detailed rules regarding the content of the due diligence investigation, specified in Appendices B and C to the Listing Procedure Rules, respectively for shares and for bonds. The sponsor will have to build a due diligence file for Amsterdam Exchanges NV to inspect.[101] If there is no prospectus requirement, there is no due diligence requirement.[102]

However, if a due diligence investigation has been performed for a simultaneous or recent public offering on an exchange abroad of the same securities, the sponsor may rely on this due diligence investigation, even though it has been performed by an institution not affiliated with Amsterdam Exchanges NV. The sponsor must look into the reputation of the foreign institution that performed the due diligence, as well as the standards of due diligence abroad, to determine whether it is justifiable to rely on the foreign due diligence. If there is a time period between the foreign due diligence and the offering in The Netherlands, Amsterdam Exchanges NV may require that additional due diligence research be performed.

There also is no due diligence requirement if the offered securities are commercial paper issued by an issuer that has been rated by one of the internationally recognised rating organisations or if the securities are commercial paper issued by a credit institution in the meaning of the Credit Supervision Act.[103]

Publication Requirements. Section 20(2) of the Listing Rules requires the prospectus to be published in one of the following manners. Either the prospectus must be published in one or more of the Dutch newspapers distributed nationally or in large quantities, or the prospectus must be published as a brochure that is available to the public at no cost at the Amsterdam Exchanges NV building, at the office of the issuer, and at the office designated for payment (generally, the sponsor's office). In addition, an advertisement must be placed in the *Prijscourant* (the official journal of the Amsterdam Exchanges NV), which contains either the entire prospectus or the place where the prospectus is made available.

Content Requirements. The Listing Rules of Amsterdam Exchanges NV contain detailed requirements regarding the content of the prospectus. Generally, section 8 of the Listing Rules prescribes that a prospectus must provide information relating to:

- The status of the issuer at the last date of the book year;
- Important events that occurred after the last day of the last book year;
- Expected developments relating to the issuer;
- Investments, finances, and the personnel of the company; and
- Rights connected to the securities.

100 Amsterdam Exchanges NV Listing Procedure Rules, Appendices B and C.
101 Amsterdam Exchanges NV Listing Procedure Rules, ss 12 and 23.
102 Amsterdam Exchanges NV Listing Procedure Rules, s 14 (4).
103 Amsterdam Exchanges NV Listing Procedure Rules, s 14.

Specific content requirements have been set out in Schedule A (for shares), Schedule B (for bonds), and Schedule C (for depository receipts for shares). There also are specific requirements for:

- Credit institutions;[104]
- Bonds guaranteed by a legal entity;[105]
- Convertible bonds;[106] and
- Depository receipts for shares.[107]

Updating Requirements. Section 21(2) of the Listing Rules requires the issuer to publish an amendment according to the general rules for publication, if any event occurs that may influence the evaluation of the offering, between the time the contents of the prospectus were determined and the time the securities are listed. Prior approval by Amsterdam Exchanges NV is necessary for an amendment as it is for a prospectus.

Exemptions from Prospectus Requirements. If a prospectus has been used to become listed on an exchange in another member state of the EU and EEA as well, the prospectus will be recognised by Amsterdam Exchanges NV if the competent authority of the other state of the EU and EEA where the issuer has its seat has approved the prospectus. The approval must be evidenced by a written declaration that must be given to the Amsterdam Exchanges NV. If there were any waivers or exemptions granted from certain requirements for the prospectus, the declaration must state the reasons for these waivers or exemption. If the issuer has its seat outside the EU or EEA, the competent authority of the exchange in the member state where the prospectus was published must issue the approval. Amsterdam Exchanges NV may require the prospectus to be translated and may require that information specifically regarding the Dutch market be included. If the issuer had obtained waivers from certain prospectus requirements, the waivers:

- Must be in accordance with the Listing Rules of the Amsterdam Exchanges NV;
- Must be justified by circumstances in The Netherlands; and
- May not include any conditions that would bar Amsterdam Exchanges NV from granting such a waiver.

However, Amsterdam Exchanges NV may recognise the prospectus even though the prospectus does not satisfy these latter three requirements.[108]

If the issuer has published a prospectus in connection with a public offer on an exchange outside the EU and EEA not more than three months before the listing on the Amsterdam Exchanges NV, the prospectus will be recognised if it is approved by the competent

104 Amsterdam Exchanges NV Listing Rules, ss 11 and 12.
105 Amsterdam Exchanges NV Listing Rules, s 13.
106 Amsterdam Exchanges NV Listing Rules, s 14.
107 Amsterdam Exchanges NV Listing Rules, s 15.
108 Amsterdam Exchanges NV Listing Rules, s 20A(2).

authority of one of the EU or EEA member states. The same requirements apply with regard to the approval, waivers and exemptions, translation, and additional information regarding the Dutch market, as described above. Additionally, any new information (as opposed to new information that influences the evaluation of the offering) must be published in an amendment to the prospectus.[109]

If the issuer has published a prospectus to become listed on an exchange in another member state of the EU or EEA not more than six months before the listing on the Amsterdam Exchanges NV, the issuer will be exempted from the requirement to publish a new prospectus. In that case, Amsterdam Exchanges NV will consult the competent authority of the member state of the EU and EEA that previously allowed the prospectus. The same competent authority must approve the prospectus and issue a written statement to that effect. However, Amsterdam Exchanges NV may condition the exemption on the updating, expansion, and translation of the prospectus. There is no prospectus requirement for:

- Offerings of securities for no consideration;
- Offerings that result from the conversion of convertible bonds; or
- Offerings that result from the exercise of warrants.

There is a very limited publication requirement for warrants.[110]

No prospectus need be published if less than 10 per cent of the market value or nominal value of already listed securities is issued, the issuer is in compliance with the disclosure requirements of Amsterdam Exchanges NV, and a limited publication is made.[111] A limited publication requirement also is the only condition for offerings to employees of already listed securities or if the listed shares are replaced by depository receipts for shares, without raising the capital of the company.[112] Also exempted are certain bonds issued by issuers that are connected in certain ways to the government of a member state of the EU or EEA.[113]

Finally, Amsterdam Exchanges NV may waive requirements to publish certain information in the prospectus, in either of two situations, namely:

- If it believes the information to be unimportant and of no consequence for the evaluation of the property, financial position, results, and prospects of the issuer; and
- If publication of the information would conflict with the public interest or would bring serious harm to the issuer, yet the omission would not mislead the public with regard to information essential to the evaluation of the offering.[114]

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109 Amsterdam Exchanges NV Listing Rules, s 20A(4) and (5).
110 Amsterdam Exchanges NV Listing Rules, s 10(3)(I).
111 Amsterdam Exchanges NV Listing Rules, s 10(3)(II)(a).
112 Amsterdam Exchanges NV Listing Rules, s 10(3)II(b) and (c).
113 Amsterdam Exchanges NV Listing Rules, s 10.
114 Amsterdam Exchanges NV Listing Rules, s 10(1).

NMAX. In addition to the requirements of the Listing Rules for the Official Market, the prospectus published in connection with a public offering on the NMAX must comply with various requirements. Any quantitative forecasts looking further ahead than the current book year must be substantiated. The accountant of the issuer will have to declare the forecasts to be in conformity with the accounting principles used by the issuer. For every shareholder holding more than five per cent of the capital of the issuer, his intentions with regard to his shares, depository receipts for shares, or options must be published. For every shareholder holding more than five per cent of the capital of the issuer, an overview of the contents of all undertakings not to alienate his shares or depository receipts for shares pursuant to section 4(2) of the NMAX Special Listing Rules, as well as an overview of the content of all other commitments regarding the shares or depository receipts for shares or options of the issuer, must be provided. Additionally, it is recommended that an English summary or translation of the prospectus be made available or accompany a prospectus.

Liability for Inaccurate Prospectus. The issuer that has used an inaccurate or misleading prospectus may be liable under the general laws of contracts (if there is a contract between issuer an investor) and torts (if there is no contract). The issuer's liability is not further discussed here. The lead manager may be liable under the laws of contracts or torts. Specifically, the rules regarding misleading advertisement[115] may be used to hold the lead manager liable. A lead manager will be held liable if the prospectus is misleading, if the lead manager is to be blamed, if the lead manager may be held to have published the prospectus, and if the plaintiff suffered damages because of the misleading prospectus.

Whether a prospectus will be misleading depends very much on all circumstances.[116] Both contents and presentation may lead a prospectus to be held misleading. Not only untrue information, but also omissions, incompleteness and even lack of clarity may be held to be misleading, depending on all circumstances. In that respect, a prospectus will be judged by a stricter standard than ordinary advertisements. The misleading information must have been essential for the evaluation of the securities by the investor.[117]

If the prospectus is misleading and the lead manager may be held to have determined the contents alone or jointly with others, the burden of proof regarding both the accuracy and correctness of the prospectus and the culpability of the lead manager shifts to the lead manager.[118] The Supreme Court has interpreted the phrase 'to determine alone or jointly with' extensively. A lead manager will be held to have determined the prospectus, unless the lead manager explicitly states not to be responsible for certain statements in the prospectus. Such a disclaimer, however, will only effect the burden of proof; it does not necessarily limit the liability of the lead manager.[119]

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115 Civil Code, Book 6, ss 194 *et seq*.
116 Civil Code, Book 6, s 194.
117 Blom, *Prospectusaansprakelijkheid van de lead manager* (1996), at pp 86–92.
118 Civil Code, Book 6, s 195.
119 Amsterdam Exchanges NV has prescribed the wording of such a disclaimer; see section 15(1) and Appendix D to the Listing Procedures Rules.

Therefore, if the lead manager determined (alone or jointly) the contents of the prospectus, he will have to prove that the prospectus is true and accurate or that he is not culpable for the fact that it is misleading. If the lead manager has issued a disclaimer regarding certain information or has not determined (alone or jointly) the contents of the prospectus, the plaintiff will have to prove both that the information or the contents of the prospectus is misleading and the culpability of the lead manager.

In most cases, the lead manager will be deemed to have published the prospectus. At least when he has made the prospectus available to the public, he will be held to have done so.[120] 'Publishing information' includes information that has previously been published.

Corporate Governance. The most general rule regarding corporate governance is the requirement that security holders in like circumstances must be treated alike.[121]

In addition, Appendix X to the Listing Rules contains some detailed requirements regarding the number and types of measures to protect against hostile take-overs that may be in place. Appendix X aims at issuers to which Dutch law applies. However, there is no exception for foreign issuers. Thus, where the corporate law rules are similar, Appendix X will probably apply. Where Appendix X would create problems, there is the possibility of obtaining dispensation from Amsterdam Exchanges NV.[122] Appendix X regulates four different types of take-over protection and their cumulation:

Preference Shares. Preference shares that may be issued without prior approval by the general meeting of shareholders, may only be issued to an independent legal entity, specifically identified in the annual statements.[123] Depending on the number of preference shares that may be issued (either 50 per cent or 100 per cent of the total outstanding shares), representatives of the issuer must have less than half the votes in the independent legal entity, or may have not more than one vote in the legal entity.[124]

Moreover, that legal entity must have as its purpose, according to its charter or articles of association, the representing of the interests of the issuer, its enterprise, and all persons involved. The protection of the independence of the issuer as a purpose is prohibited.[125]

The decision to issue the preference shares must be taken by the general meeting of shareholders or by the supervisory board, if it exists and if the general meeting of shareholders has delegated the authority to issue preference share to the management board.[126] Within four weeks, the general meeting of shareholders must be convened to explain why the

120 Blom, *Prospectusaansprakelijkheid van de lead manager* (1996), at pp 80–84.
121 Amsterdam Exchanges NV Listing Rules, ss 26 (shares), 32 and 37 (bonds), and 42 (participations).
122 Amsterdam Exchanges NV Listing Rules, Appendix X, s 14.
123 Amsterdam Exchanges NV Listing Rules, Appendix X, s 2.
124 In the latter case, there also are restrictions with regard to who may be the representative of the issuer.
125 Amsterdam Exchanges NV Listing Rules, Appendix X, s 2(c).
126 Both the general meeting of shareholders and the supervisory board are corporate institutions in Dutch corporate law.

preference shares were issued. Within two years of the issuance of the preference shares, a general meeting of shareholders must be convened to decide on recalling the preference shares. If it is not so decided, every two years after that meeting, another meeting on the same topic must be held.[127]

Depository Receipts for Shares. Non-convertible depository receipts for shares are not allowed.[128] The trust that administers the shares underlying the depository rreceipts must be independent and have a purpose as described above for preference shares.

There is one difference with preference shares, namely, if the foundation administers the shares of more than one issuer, the requirements regarding the purpose of the foundation do not apply. The foundation must then comply with section 15 of Appendix II of the Listing Rules, which requires the foundation to exercise its powers in accordance with the interests of the depository receipt holders.

Priority Shares. Priority shares are those to which some specific rights are attached with regard to corporate powers, eg, the right to make a binding nomination for board members. The names of the persons ultimately responsible for casting the priority votes and their office in the issuers, if they have one, must be published in the annual statements.[129] Not more than half the priority shares may be issued to members of the board.[130]

Pandora's Box Constructions. 'Pandora's Box' constructions include 'poison pills' and 'crown jewel' constructions, also known as 'porcupine' provisions. Section 12 of Appendix X of the Listing Rules requires the issuer to publish immediately any decision it has taken which has the exclusive purpose to frustrate a hostile tender offer, as well as any contracts concluded for such purpose.

Cumulations of Take-Over Protection Measures. The cumulation of a maximum of two of the take-over protection measures, as described above, is allowed in certain circumstances. More particularly, as long as the total amount of preference shares issued is not more than 50 per cent of the total outstanding shares, the issuer has more choice as to which take-over protection measures to cumulate. If the total number of preference shares is 100 per cent of total outstanding shares, this may only be combined with priority shares.[131] There are some additional, detailed rules.

New Legislation. There is currently legislation pending that creates the possibility for a holder of 70 per cent of the shares during a period of one year to apply to the Court of Appeal in Amsterdam to lift take-over protection measures. If enacted, the proposed

127 Amsterdam Exchanges NV Listing Rules, Appendix X, ss 3 and 4.
128 Amsterdam Exchanges NV Listing Rules, Appendix X, s 5.
129 Amsterdam Exchanges NV Listing Rules, Appendix X, s 9.
130 Amsterdam Exchanges NV Listing Rules, Appendix X, s 10.
131 Amsterdam Exchanges NV Listing Rules, Appendix X, s 13(a) and (b).

legislation will make Appendix X superfluous to a large extent. However, the future of the Bill is yet uncertain. Moreover, the Bill would only be applicable to corporations governed by Dutch law.[132]

Unlisted Securities

Issuer Requirements. There are no specific requirements under Dutch law that must be fulfilled to issue securities. Corporations will only be able to issue securities if they can do so according to the law that applies to their internal organisation. In that respect, it should be noted that, according to Dutch conflict-of-laws rules, the law of the place where the corporation was formed applies to the formation, the internal structure and relations, and the dissolution and liquidation of the corporation. Therefore, the law of the place of formation will determine whether shares or bonds may be issued by the corporation.

Securities Requirements. Either the Act on Supervision of Securities Trade 1995 or the Act on Supervision of Investment Undertakings will apply to securities that fall within the definition of securities of the Acts. Both Acts use the same definition. If securities are not within this definition, generally, they are not regulated. Section 1(a) of the Act on Supervision of Securities Trade 1995, which is identical to section 1(g) of the Act on Supervision of Investment Undertakings, contains the following definition of securities:

> 1. share certificates, debt instruments, profit participation rights, founders' shares, option certificates, warrants and similar instruments;
>
> 2. participation rights, options, futures, entries in share and debt registers, and similar, either conditional or unconditional, rights;
>
> 3. certificates of values mentioned above;
>
> 4. provisional certificates or depository receipts of values mentioned above.

Specifically excluded by section 2 of the Act on Supervision of Securities Trade 1995 and by section 2 of the Act on Supervision of Investment Undertakings are securities that are exclusively instruments of payment and condominium rights. Instruments of payment are money, cheques, and drafts.

The definition of securities in the Act on Supervision of Securities Trade 1995 and the Act on Supervision of Investment Undertakings is not exclusive. Therefore, it is not clear exactly what are and what are not securities. The lack of clarity is compounded by the use of the words 'similar rights'. According to the Minister of Finance in the parliamentary debates, the 'similar rights' clause would give him most flexibility and effectiveness to respond to new developments in the market.[133]

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132 *Tweede Kamerstukken* Number 25732, no 2.

133 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at pp 181 and 182.

Considering the very broad definition of securities, the general conclusion is that few investment instruments will escape the applicability of the Act on Supervision of Securities Trade 1995 or the Act on Supervision of Investment Undertakings.

Prospectus Requirements for Unlisted Securities. Generally, if there is an offer of securities outside a closed circle, a prospectus must be made available.[134] This is true for all securities that fall within the definition of securities of the Act on Supervision of Securities Trade 1995. Violation of this prohibition is a criminal offence, punishable with a fine of NLG 25,000 and/or two years' imprisonment for natural persons and a fine of NLG 100,000 for legal entities.[135] In addition, violation of statutory duties may lead to voidness or avoidability of the transaction. However, this is debated.[136]

Publication Requirements. There are no specific requirements regarding means of publication of a prospectus. However, section 3(2)(b) of the Act on Supervision of Securities Trade 1995 requires the prospectus to be generally available. In addition, any written publication of the offering must refer to the prospectus. Any advertisements or documents holding out the offering must state the time and place where the prospectus will be published or made generally available. These advertisements or documents, as well as the prospectus itself, must be sent to the Securities Board of The Netherlands, for information purposes only. There is no formal approval procedure.[137]

The Securities Board of The Netherlands may require the prospectus to be in one or more languages if this is necessary to adequately inform investors, considering the possible area of distribution of the prospectus.[138]

Content Requirements. There are detailed requirements regarding the content and structure of a prospectus, pursuant to the Act on Supervision of Securities Trade 1995. These detailed rules have been designed to follow the requirements of Directive 80/390/EEC (requirements for prospectus for listed securities) to give investors in listed securities and investors in unlisted securities information of roughly the same quality. However, the requirements sometimes exceed the requirements of Directive 89/289/EEC (requirements for prospectus for public offerings of unlisted securities) since, for unlisted securities, the prospectus, will generally be the only available source of information.

The requirements are set out in section 2(1) and (2) of the Decree on the Supervision of Securities Trade and the Appendix to the Decree on the Supervision of Securities Trade. Requirements vary for different types of securities (eg, futures, shares, or bonds). Additionally, the Securities Board of The Netherlands has issued a rule that requires every prospectus to begin with a summary containing the most important information.[139]

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134 Act on Supervision of Securities Trade 1995, s 3(2)(b).
135 Economic Offences Act (*Wet Economische Delicten*), s 6(1)(2).
136 Civil Code, Book 3, s 40.
137 Decree on the Supervision of Securities Trade, ss 4 and 5(1).
138 Decree on the Supervision of Securities Trade, s 2(4).
139 Further Regulation Act on Supervision of Securities Trade 1995, s 2.

Updating Requirements. Any new information, omissions, inaccuracies, or mistakes, occurring or discovered between the time of finalisation of the prospectus and the time the offering ends that may be important for the evaluation of the financial situation of the issuer, the performance and prospects of the issuer, and the rights and obligations connected with the securities must be published in an amendment to the prospectus. This amendment must be made generally available as well, after it has been sent to the Securities Board of The Netherlands. After sending the amendment to the Securities Board of The Netherlands, it is considered to be part of the prospectus.[140]

Issuers that offer securities regularly have the possibility to use a prospectus written for a previous offering of securities, updated by an amendment as described above, if the following conditions have been met:

- The prospectus may not have been used more than 12 months before the new offering;
- The prospectus must have complied either with section 2 (proscribing content requirements) or with section 3 (excepting prospectus approved by EU and EEA Competent Authorities) of the Decree on the Supervision of Securities Trade; and
- The amendment must always be accompanied by the prospectus that is amended.

Note that the prospectus need not have been written for the same type of securities.[141]

Exceptions. There are some general exceptions to the general prohibition of offerings without a prospectus of the Act on Supervision of Securities Trade 1995. Firstly, the requirement that a prospectus must be published does not apply to securities listed on an officially recognised exchange.[142] Of course, to be listed on an exchange, one will have to publish a prospectus according to the rules of the exchange. Secondly, the prospectus requirements do not apply to offerings of securities that are listed on an officially recognised exchange of a member state of the EU or EEA.[143] Thirdly, offerings of securities of investment undertakings are governed by the rules of the Act on Supervision of Investment Undertakings (see text, below).

Pursuant to section 3(c) of the Act on Supervision of Securities Trade 1995, the Decree on the Supervision of Securities Trade creates an exception for issuers from the EU and EEA that have published a prospectus in another member state. These issuers need not comply with the specific content requirements of section 2(1) and (2) of the Decree on the Supervision of Securities Trade if they have obtained the approval of the Competent Authority of their home country, pursuant to Directive 89/298/EEC (prospectus requirements for unlisted securities) no longer than six months before the offer and their prospectus complies with article 8 or article 12 of that Directive, ie, the prospectus complies with the requirements for a prospectus for listed securities, as detailed in Directive 80/390/EEC. If

140 Decree on the Supervision of Securities Trade, s 6(1).
141 Explanatory Memorandum to section 6 of the Decree on the Supervision of Securities Trade, at p 12.
142 Act on Supervision of Securities Trade 1995, s 3(2)(a).
143 Explanatory Memorandum Decree on the Supervision of Securities Trade, ch 2.2.1.

they have obtained the approval of the Competent Authority of their home country, pursuant to Directive 89/298/EEC (prospectus requirements for unlisted securities) no longer than six months before the offer and their prospectus complies with article 8 or article 12 of that Directive, ie, the prospectus complies with the requirements for a prospectus for listed securities, as detailed in Directive 80/390/EEC. If they have obtained a waiver for some of the requirements of these provisions, the Securities Board of The Netherlands must agree that the waiver is appropriate for the offering of the securities in The Netherlands.

The Securities Board of The Netherlands may order that additional information be added to the prospectus.[144] If the Competent Authority has waived certain requirements, prior approval of the Securities Board of The Netherlands, contrary to ordinary procedure, is required. However, the prospectus must comply with the requirements regarding means of publication, language and structure of the prospectus as described above.

Exemptions. In addition, the Minister of Finance has promulgated the Exemption Regulation, which contains the following exemptions, based on section 4(1) and (2) of the Act on Supervision of Securities Trade 1995:

- Professionals — Firstly, all offerings of securities or the holding out of an offering to any natural person or legal entity that is professionally engaged in the securities trade, need not be accompanied by a prospectus.[145] To be a professional, a person or legal entity must perform transactions in securities in the course of or directly connected with its profession or occupation.[146] Examples are broker and dealers, institutional investors (eg, pension funds), treasury departments of large corporations, investment undertakings, and credit institutions. However, to fall within the exemption, the offering memorandum, or any other advertisement or document holding out the offering, must explicitly state that the offering is only aimed at professionals. Copies of these documents must be sent to the Securities Board of The Netherlands before use. The restriction of this exemption to professionals applies to secondary trade as well. Section 3(3) of the Act on Supervision of Securities Trade 1995 requires publication of a prospectus for all offerings of securities that have previously only been available to professionals.
- Offerings exclusively to persons or entities outside The Netherlands — Section 3 of the Exemption Regulation exempts offerings of securities or the holding out of an offering to buy securities if aimed exclusively at persons or legal entities that are domiciled or have their habitual place of residence outside The Netherlands. It is Dutch law that determines domicile and habitual place of residence in this context. The relevant provision is section 10 of Book 1 of the Civil Code. The residence of a natural person is the place where he has his home or, if he has no home, the place where he actually resides. A legal entity resides in the place the law assigns to it, or in the place provided

144 Decree on the Supervision of Securities Trade, ss 3 and 5(3).
145 Exemption Regulation of the Act on Supervision of Securities Trade 1995, s 2(1).
146 Explanatory Memorandum to Section 2 of the Exemption Regulation.

in the charter or articles of association of the legal entity. Additionally, section 14 of Book 1 of the Civil Code provides that, if a legal entity has a branch office, that place will be considered its residence for all matters concerning that branch office. The exemption is conditioned in that (a) the offering memorandum, or any advertisements or documents holding out the offering, must explicitly state that it is only aimed at persons or entities residing outside The Netherlands; (b) the offering must comply with the laws of the State in which the persons or entities at which the offering is aimed reside; (c) prior to the offering, a statement of compliance with the requirement under (b) must be filed with the Securities Board of The Netherlands; and (d) the statement is made part of the offering or any advertisement or document holding out the offering.

- Euro-issues — No prospectus need be published if an offering or the holding out of an offering concerns Euro-securities and if no general advertisement or vending campaign is held.[147] Euro-securities are securities that: (a) are underwritten by a consortium of which at least two members are domiciled in different member states of the EU or EEA; (b) have at least 60 per cent of the total amount underwritten by members of the consortium that reside in a different country than the issuer; and (c) are only offered through the agency of banks, or professional securities institutions.
- Other exemptions — If the securities that are offered are only available in denominations of NLG 100,000 or more, or the foreign currency equivalent, the offering is exempted from the prospectus requirement.[148] Offerings of securities for no consideration are exempted, as well.[149] Short-term notes, commercial paper, and like securities that have a term of not more than one year and are issued by a bank are exempted. No prospectus need be published for the offering of securities issued by investment undertakings that have been exempted from the licence requirement of the Act on Supervision of Investment Undertakings. Finally, all offerings of securities issued by member states of the EU or EEA, a territorial public entity, or a legal entity according to public international law, of which one or more member states are a part are exempted.
- Individual exemptions — Pursuant to section 4(1) of the Act on Supervision of Securities Trade 1995, individual exemptions may be granted by the Securities Board of The Netherlands. These exemptions have been granted for offerings of securities that occurred simultaneously in the United States and The Netherlands and where the offering had been registered with the Securities Exchange Commission. The Explanatory Memorandum to the Act on Supervision of Securities Trade 1995 remarks that there may be a case for an exemption when securities are offered simultaneously in more than one country and where the prospectus requirements of those countries are incompatible, or where full compliance with the prospectus requirements would be unduly burdensome to the issuer, whereas no investor interest would be served.[150]

147 Exemption Regulation of the Act on Supervision of Securities Trade 1995, s 6.
148 Exemption Regulation of the Act on Supervision of Securities Trade 1995, s 4.
149 Exemption Regulation of the Act on Supervision of Securities Trade 1995, s 5.
150 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at p 222.

Corporate Governance. There has been much debate recently regarding corporate governance in The Netherlands. In 1996, a report was published by the Peters Commission, containing 40 recommendations to improve governance within Dutch corporations. Since this discussion is interesting only for Dutch corporations and since the recommendations were not binding, suffice it to say that the general drive of the report was to increase transparency and shareholder influence.

There are no legal rules regarding corporate governance for corporations that issue securities. There are, of course, detailed rules regarding corporate governance for corporations to which Dutch corporate law applies. In addition, as discussed above, for limited securities, there is legislation pending with regard to take-over protection measures.

Securities Issued by Investment Undertakings.

Issuer Requirements. A category of issuers that must fulfil specific requirements are investment undertakings. Section 4(1) of the Act on Supervision of Investment Undertakings prohibits the offering of securities or the accepting of money and goods by an investment undertaking, outside a closed circle, unless that investment undertaking has a licence from the Dutch Central Bank. This also is true for investment undertakings that are listed on an officially recognised exchange. Therefore, any investment undertaking, like a mutual fund, that wants to offer its securities in The Netherlands, must have a licence, unless an exception or exemption applies. There are two types of investment undertakings, namely:

- Investment firms; and
- Investment funds.

The former is a legal entity (eg, a public or closed corporation or foundation) that solicits or has obtained money or goods for the purpose of collectively investing them, to make all participants share in the profits. The latter is not a legal entity (eg, a partnership or limited partnership) that solicits or has obtained money or goods for the purpose of collectively investing them, to make all participants share in the profits.[151] An investment fund must have both a manager (*beheerder*) and a depositary (*bewaarder*).

According to the Explanatory Memorandum to the Act on Supervision of Investment Undertakings, holding companies, banks, and insurance companies are not investment undertakings. The purpose of the first is to provide capital; the latter's purpose is not to collectively invest. In addition, there has been discussion as to what it means to 'collectively invest'. For example, what if an individual investment is suggested to a number of individuals? According to the Dutch Central Bank, individual investments must clearly state they are individual, and the individual character of the investment must be clear in practice, as well.[152] It is a criminal offence to be or maintain an investment undertaking

151 Act on Supervision of Investment Undertakings, s 1(a) and (b).
152 Grundmann-van der Krol, *Koersen door Effectenrecht* (1997), at p 92.

without the proper licence from the Dutch Central Bank, unless an exception or exemption applies.

Exceptions to Licence Requirement. Undertakings for collective investment in transferrable securities (UCITS) are open-end investment undertakings that, according to their charter or articles of association, invest exclusively in securities, using the principle of 'risk spreading' (eg, mutual funds).[153] Investment undertakings that qualify as UCITS and have their seat in another member state of the EU or EEA that has implemented the UCITS Directive 85/611/EEC need not apply for a licence. However, a UCITS must notify the Dutch Central Bank of its intention to offer its participations outside a closed circle in The Netherlands. The following documents should accompany such a notification:

- A statement from the competent authority of the UCITS' home country that the UCITS fulfils all requirements of Directive 85/611/EEC;
- The charter or articles of association and bye-laws;
- A prospectus;
- If applicable, the latest annual and half-yearly financial statements; and
- A statement regarding the way information will be provided to Dutch investors and the way trading, payment, and repurchase of participations will take place.[154]

If there is any publication requirement according to the law of the home country of the UCITS, the publication must be made in the Dutch language, as well.[155] In addition, the UCITS must take all necessary measures to ensure the dissemination of information and the payment on participations and/or repurchases of participations in The Netherlands.[156]

Unless the Dutch Central Bank gives notice that the UCITS is not within the scope of the Directive 85/611/EEC or that the UCITS' proposed activities violate Dutch law, the UCITS may start offering its participations after two months have passed after notifying the Dutch Central Bank.[157]

In addition, natural persons who offer participations not in the pursuit of their profession or occupation do not need a licence under the Act on Supervision of Investment Undertakings.[158]

Exemptions. Pursuant to section 14 of the Act on Supervision of Investment Undertakings, the Minister of Finance has issued the Exemption Regulation to the Act on Supervision of Investment Undertakings. This regulation creates two exemptions from the licence requirement. The first exemption is for offerings of participations in and solici-

153 Act on Supervision of Investment Undertakings, s 6(1)(a) and (b).
154 Act on Supervision of Investment Undertakings, s 17(2).
155 Act on Supervision of Investment Undertakings, s 17(3).
156 Act on Supervision of Investment Undertakings, s 17(6).
157 Act on Supervision of Investment Undertakings, s 17(4).
158 Act on Supervision of Investment Undertakings, s 4(2)(b).

tations for money for investment undertakings exclusively to and from professionals.[159] In this case, secondary trade is limited to professionals, as well. Even though the Act on Supervision of Investment Undertakings does not explicitly so require, the Dutch Central Bank does require this selling restriction. The second exemption from the licence requirement is for investment undertakings that have been officially recognised as so-called 'private participation firms', ie, venture capital firms that have been guaranteed by the government. Due to the uncertainty of the 'closed circle' criterion and a recent scandal regarding an investment club, the Exemption Regulation to the Act on Supervision of Investment Undertakings is under review.

Foreign Non-Exempt Investment Undertakings. When none of the exceptions or exemptions applies, an investment undertaking will have to apply for a licence. However, since the Dutch Central Bank has no means of enforcing the Act on Supervision of Investment Undertakings effectively against offshore investment undertakings, it has a policy of granting licences only to investment undertakings from certain countries. Licences will be granted to investment undertakings from the United States, Jersey, Guernsey, and Luxembourg. Investment undertakings from these countries may even obtain exemptions from certain requirements for a licence. The Dutch Central Bank considers the supervision in these countries over investment undertakings to be sufficient.

However, investment undertakings from countries that, in the Dutch view, lack sufficient supervision, specifically Bermuda, the Cayman Islands, and the British Virgin Islands, will not be granted a licence, unless they are able to meet quite strict conditions. These include the conditions that:

- A representative office be located in The Netherlands that has a formal relationship with a Dutch financial institution;
- At least two board members be resident in The Netherlands;
- The records of the investment undertaking be available in The Netherlands;
- The information that must be available to the public according to law be available in The Netherlands; and
- The investment undertaking have a Dutch auditor.

Investment undertakings from Aruba and the Netherlands Antilles may obtain a licence if all requirements for a licence are met and all board members and the records of the investment undertaking are resident on Aruba or the Netherlands Antilles.[160]

159 Regulation of 9 October 1990. For the meaning of the word 'professionals', see the discussion of exemptions from the prospectus requirement for the offering of securities under the Act on Supervision of Securities Trade 1995.

160 Klemann, 'Beleid ten aanzien van buitenlandse beleggingsinstellingen die actief zijn in of vanuit Nederland (Deel 1)', *Vennootschap en Onderneming* (March 1993), at pp 32 and 33; Klemann, 'Beleid ten aanzien van buitenlandse beleggingsinstellingen die actief zijn in of vanuit Nederland (Deel 2)', *Vennootschap en Onderneming* (June 1993), at pp 68–70.

Licence Requirements. If an investment undertaking must obtain a licence, it must meet the following requirements[161] regarding expertise and reliability, capital adequacy, business organisation, and information to the public (see text, below, for prospectus and disclosure requirements):

- Expertise and reliability — Those persons who represent the investment undertaking or determine its policies must have sufficient expertise and be reliable. Those persons who have the power to appoint or fire the representatives or persons that determine policy must merely be reliable.[162] Appointments of persons who fall within these categories require the prior approval of the Dutch Central Bank.[163]
- Capital adequacy — The investment undertaking must have an equity capital of at least NLG 500,000. The depositary must have a capital of at least NLG 250,000, and it must provide collateral or insurance to cover liability for damages arising from fire, transport, fraud, and robbery.[164]
- Business organisation — At least two persons must determine the day-to-day policy of the investment undertaking. In addition, the conditions that the investment undertaking uses when issuing and selling shares must comply with a detailed set of requirements that are set out in Appendix A to the Decree on the Supervision of Investment Undertakings. If there is a depositary, it must have concluded an agreement with the investment undertaking that incorporates the above-mentioned conditions.
- Information to the public and participants (see text, below, relating to prospectus requirements and disclosure requirements).

If the investment undertaking is not a legal entity (ie, it is an investment fund), it will have to meet additional criteria, namely:

- The property of the fund must be deposited with a depositary;
- The depositary must be a legal entity; and
- The property of the fund must be separated both from the property of the manager, the depositary, or any other natural person or legal entity.[165]

Only professional depositaries are allowed.[166]

161 Act on Supervision of Investment Undertakings, s 5.
162 Decree on the Supervision of Investment Undertakings, s 2.
163 Act on Supervision of Investment Undertakings, s 12; Decree on the Supervision of Investment Undertakings, s 11.
164 Decree on the Supervision of Investment Undertakings, s 3.
165 Act on Supervision of Investment Undertakings, s 5.
166 Act on Supervision of Investment Undertakings, s 9.

Exemptions may be granted from the requirements for a licence if they reasonably cannot be met and if the purposes of the Act on Supervision of Investment Undertakings are otherwise served sufficiently.[167]

Additional Requirements for Undertakings for Collective Investments in Transferrable Securities. UCITS that have their seat in The Netherlands (or, in the case of an investment fund, if the manager of the fund has its seat in The Netherlands) must meet additional requirements. Section 6 of the Act on Supervision of Investment Undertakings requires Netherlands-based UCITS to:

- Have their head office in The Netherlands (or, in case of an investment fund, to have the head office of the manager of the fund in The Netherlands);[168]
- Limit the activities of the manager of an investment fund to the management of the fund;[169]
- Limit the activities of the investment undertaking to those that make it a UCITS;[170]
- Deposit the assets of an investment firm with an independent, professional depositary;[171] and
- Ensure the depositary has its seat in a member state of the EU or EEA and a branch in The Netherlands.[172]

There are exceptions from these additional requirements for UCITS in the following circumstances:

- If the UCITS does not solicit funds from the public in a member state of the EU or EEA;
- If the UCITS' charter or articles of association or bye-laws only allow it to sell its securities to members of the public outside the EU or EEA;
- If the UCITS invests its assets through subsidiaries mainly in other assets than securities; or
- If the UCITS is of a type that has been designated by the Minister of Finance as exempted from the rules regarding investing and borrowing for UCITS.[173]

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167 Act on Supervision of Investment Undertakings, s 5(3).
168 Act on Supervision of Investment Undertakings, s 6(2).
169 Act on Supervision of Investment Undertakings, s 6(3).
170 Act on Supervision of Investment Undertakings, s 6(49.
171 Act on Supervision of Investment Undertakings, s 9. However, investment firms listed or to be listed within a year on an officially recognised exchange are exempted if their shares will be available only on the exchange and their charter or articles of association state the method to compute the intrinsic value of its shares (Decree on the Supervision of Investment Undertakings, s 9(1)). If the last two criteria are not met, an exemption is still possible, but several additional criteria must be met (Decree on the Supervision of Investment Undertakings, s 9(2)). In addition, such investment firms have some additional obligations (Decree on the Supervision of Investment Undertakings, s 10).
172 Act on Supervision of Investment Undertakings, s 6(5).
173 Act on Supervision of Investment Undertakings, s 7.

The last exception applies, for example, to a UCITS that predominantly invests in unlisted securities.[174] Note that, if an exception to section 6 of the Act on Supervision of Investment Undertakings applies, the general requirements of section 5 still must be met. Finally, exemptions may be granted by the Dutch Central Bank from these requirements if they reasonably cannot be met and if the purposes of the Act on Supervision of Investment Undertakings are otherwise served sufficiently.

Continuing Obligations. A licence may contain restrictions, but only with regard to its scope and duration.[175] For example, if the management of an Investment institution has experience only with investment in securities, the licence may be limited to investments in securities.[176] Restrictions must be warranted by the needs of an adequately functioning market and the protection of investors on this market.[177] The licence may be revoked in certain circumstances.[178]

If an investment undertaking has its seat or is controlled by a legal entity that has its seat in a state not a member of the EU or EEA that does not admit Dutch financial institutions or unreasonably burdens Dutch financial institutions, the Dutch Central Bank may revoke, change, or condition the licence of that investment undertaking. Pursuant to section 12m of the Act on Supervision of Investment Undertakings, investment undertakings that have obtained a licence must comply with a set of requirements that closely resemble the requirements to obtain a licence in order not to lose their licence. The Decree on the Supervision of Investment Undertakings specifies these requirements.[179] There are general requirements that all investment undertakings must comply with and additional rules for UCITS.[180]

The auditor of the investment undertaking is under a legal obligation to notify the Dutch Central Bank immediately if he, on checking the annual statements of the investment undertaking, finds that:

- The conditions of the licence are violated;
- The Act on Supervision of Investment Undertakings is otherwise violated;
- The existence of the investment undertaking is threatened; or
- He cannot issue a declaration about the truthfulness of the annual statement without exceptions.[181]

In addition, the auditor must be authorised by the investment undertaking to provide the Dutch Central Bank with all information that is reasonably necessary for the Dutch

174 Explanatory Memorandum to the Act on Supervision of Investment Undertakings, at p 19.
175 Act on Supervision of Investment Undertakings, s 8.
176 Explanatory Memorandum to the Act on Supervision of Investment Undertakings, at p 19.
177 Act on Supervision of Investment Undertakings, s 8.
178 Act on Supervision of Investment Undertakings, ss 15 and 16.
179 Decree on the Supervision of Investment Undertakings, ss 11–23.
180 Decree on the Supervision of Investment Undertakings, ss 24–45.
181 Act on Supervision of Investment Undertakings, s 12(4) and (5).

Central Bank to supervise the investment undertaking.[182] The auditor is not liable for this notification, unless he reasonably should not have notified the Dutch Central Bank.[183]

Prospectus Requirements. Pursuant to section 5(1)(d) of the Act on Supervision of Investment Undertakings, an investment undertaking must comply with requirements regarding information to be given to the public and participants to obtain the necessary licence (see text, above, for the other requirements). Consequently, section 6 of the Decree on the Supervision of Investment Undertakings requires the investment undertaking to have a prospectus available in order to be eligible for a licence.

- Publication requirements — Section 6 of the Decree on the Supervision of Investment Undertakings merely requires the investment undertaking to have a prospectus available. There are no further requirements regarding the means of publication. Section 7 of the Decree on the Supervision of Investment Undertakings requires the prospectus to be sent to the Dutch Central Bank, together with the licence application. The Dutch Central Bank does not formally approve the prospectus, and it is not liable for errors in it.[184] Pursuant to section 6(6) of the Decree on the Supervision of Investment Undertakings, the Dutch Central Bank may require the investment undertaking to have the prospectus available in one or several languages if, according to the Dutch Central Bank, the intended distribution of the prospectus so requires to adequately inform the public. Pursuant to the continuing obligations under the licence,[185] the prospectus must be available free of charge the day before issue of securities, the opening of participation in the investment undertaking, or the written holding out of the opening to participants. The places where the prospectus is available must be mentioned in any holding out of the offering.[186]
- Content requirements — The prospectus must contain all information necessary to enable investors to make a sound evaluation of the offering of the securities of the investment institution.[187] There are detailed minimum content requirements for the prospectus, set out in Appendix B to the Decree on the Supervision of Investment Undertakings. Among other material, the prospectus must contain a statement by an auditor that it complies with the Decree on the Supervision of Investment Undertakings and a statement by the responsible persons that, to their knowledge, the prospectus is true and complete. In addition, the conditions used in transactions with investors, or a summary thereof, must be included.[188]
- Updating requirements — A closed-end investment undertaking must update all essential information every time it issues new shares or participations outside a closed circle.

182 Act on Supervision of Investment Undertakings, s 19(4).
183 Act on Supervision of Investment Undertakings, s 12(6).
184 Explanatory Memorandum to the Decree on the Supervision of Investment Undertakings.
185 Act on Supervision of Investment Undertakings, s 12.
186 Decree on the Supervision of Investment Undertakings, s 18(1).
187 Decree on the Supervision of Investment Undertakings, s 6(2).
188 Decree on the Supervision of Investment Undertakings, Appendix B, part I, s 1.2, part II, s 2.4, and part III, s 3.2.

An open-end investment institution must update all essential information when the information changes or becomes known.[189] The prospectus and the update may only be made available after sending it to the Dutch Central Bank.[190]

Exceptions and Exemptions. Whether an investment undertaking must publish a prospectus depends firstly on whether it must apply for a licence. If an exception to the licence requirements applies that exception will determine whether a prospectus nevertheless must be published (see text. above). However, if a prospectus must be published according to section 6 of the Decree on the Supervision of Investment Undertakings, there are certain exemptions from the content requirements as well as from the publication and updating requirements.[191]

Investment undertakings that do no fall within section 6(1) of the Act on Supervision of Investment Undertakings (ie, do not have their seat in The Netherlands and are not UCITS) and whose securities have previously been available in The Netherlands outside a closed circle will have their prospectus recognised if they have a written declaration from the competent authority of an EU or EEA member state that their prospectus complies with the requirements for investment undertakings of Directive 80/390/EEC. According to the Explanatory Memorandum, therefore, if an investment undertaking has issued securities in another member state of the EU or EEA on an officially recognised EU or EEA exchange, its prospectus will be recognised.[192] The Dutch Central Bank cannot require the prospectus to be translated.

Non-UCITS or non-Netherlands-based UCITS that have not offered their securities outside a closed circle in The Netherlands are exempted from the content requirements if (a) an offering will take place in The Netherlands not more than six months after an offering outside a closed circle in another EU or EEA member state, and (b) the investment undertaking provides a written statement from the competent authority that its prospectus complies with sections 7, 8, and 12 of Directive 89/289/EEC. This only applies to closed end investment undertakings. However, the Dutch Central Bank may require additional information to be included that specifically relates to the Dutch market.[193] If a public offering is done simultaneously with an offering on an exchange, section 6(3) and (4) will overlap.[194]

Non-UCITS or non-Netherlands-based UCITS that are or will shortly be listed on an exchange appointed by the Dutch Central Bank as exempted, are exempted pursuant to section 6(5) of the Decree on the Supervision of Investment Undertakings. Since, for listing on an exchange, a prospectus will have to be published in any event, additional prospectus requirements do not make sense. The Dutch Central Bank, however, may

189 Decree on the Supervision of Investment Undertakings, s 18(2) and (3).
190 Decree on the Supervision of Investment Undertakings, s 18(5).
191 Decree on the Supervision of Investment Undertakings, ss 6 and 18(1) and (4).
192 Section 6(3) of the Decree on the Supervision of Investment Undertakings is poorly formulated, and one needs to read the Explanatory Memorandum to understand that listed securities on EU and EEA exchanges are exempted.
193 Decree on the Supervision of Investment Undertakings, s 6(4).
194 Explanatory Memorandum to the Decree on the Supervision of Investment Undertakings.

require additional information to be included. According to the Explanatory Memorandum, Amsterdam Exchanges NV would be appointed as such an exempted exchange. However, no decree has been published with such an appointment.

Corporate Governance. In The Netherlands, there are no specific rules for corporate governance for investment undertakings.

Periodic Disclosure

Listed Securities

Official Market

In General. In addition to any disclosure requirement imposed by laws or regulations under the applicable law to the issuer, Amsterdam Exchanges NV imposes certain periodic disclosure requirements. In addition, Amsterdam Exchanges NV may require an issuer to publish additional information and, if the issuer refuses to do so, may publish it itself.[195] Additionally, section 6 of the Act on Supervision of Securities Trade 1995 empowers the Minister of Finance to notify Amsterdam Exchanges NV, or even to direct Amsterdam Exchanges NV, to take action against listed issuers that do not comply with the periodic disclosure duties under the Listing Rules. This power has not been delegated to the Securities Board of The Netherlands.[196]

General Rules for the Annual Statements. If the issuer has its seat in a member state of the EU or EEA, its annual statements must be in accordance with the law of that state. If the issuer has its seat in a state not a member of the EU or EEA, its annual statements must be in accordance with Dutch law or rules that are, in the opinion of Amsterdam Exchanges NV, equal to those of Dutch law.

Disclosure of Certain Events. An issuer must inform its shareholders of a number of specific events. Most notably, an issuer must inform its investors of:

- Dividends;
- Shareholders' meetings; and
- Issuance of shares.[197]

An issuer must inform the public of changes in structure or ownership of important holdings of its shares.[198] This obligation corresponds exactly with the obligations under the Major Holdings Disclosure Act (see text, below). It does not apply to issuers that are founded under the laws of a member state of the EU or EEA because they fall within the

195 Amsterdam Exchanges NV Listing Rules, s 18.
196 Delegation Decree, s 2(a) and (b).
197 Amsterdam Exchanges NV Listing Rules, s 28.
198 Amsterdam Exchanges NV Listing Rules, s 28(f).

purview of Directive 88/627/EEC (providing for disclosure of substantial interest in listed corporations) and, therefore, they already must publish significant changes in ownership. Changes in the rights connected to shares or depository receipts for shares must be immediately published, as well as significant changes in activities and significant changes in the board.[199]

Finally, any information or event concerning the issuer that should be considered to have a significant effect on the price of the shares (ie, depository receipts for shares) must immediately be published. Amsterdam Exchanges NV may grant dispensation from this requirement.[200]

Periodic Disclosure to Public. An issuer of shares or depository receipts for shares must make its annual and semi-annual statements available to the public.[201] There are some additional rules with regard to the content and time of publication of the annual and semi-annual statements.[202] In addition, Dutch corporations may be required under Dutch law to publish quarterly statements if they are listed on an exchange.[203]

Bond issuers need not publish semi-annual statements, but they do need to publish information regarding new loans. Governmental bond issuers do not need to publish annual statements. Investment funds must publish an annual statement regarding the management of the fund.[204]

Issuers Listed on Foreign Exchange. If the issuer is listed on the Official Market, as well as on other exchanges in the EU and EEA, it is under an obligation to ensure that, on each exchange, information of equal value is disseminated. If the issuer is listed on an exchange outside the EU or EEA and on the Official Market, information must be provided that is at least equal to the information provided to the foreign market, to the extent that this information may be of interest for the valuation of the shares or depository receipts for shares.[205]

Disclosure to Amsterdam Exchanges NV. The issuer must discuss changes in its charter or articles of association with the Amsterdam Exchanges NV, prior to informing its shareholders.[206] In addition, Amsterdam Exchanges NV must receive immediately all annual and semi-annual statements and other documents that are available to shareholders. Amsterdam Exchanges NV also must be informed immediately of significant

199 Amsterdam Exchanges NV Listing Rules, s 28(g) and (j).
200 There also are some specific exceptions, for example, with regard to the intervention of the Dutch Central Bank in investment undertakings that were meant not to be published. Amsterdam Exchanges NV Listing Rules, s 28(h).
201 Amsterdam Exchanges NV Listing Rules, s 28(c).
202 Amsterdam Exchanges NV Listing Rules, s 29.
203 Civil Code, Book 2, s 103.
204 Amsterdam Exchanges NV Listing Rules, s 34(h), 39, and 42.
205 Amsterdam Exchanges NV Listing Rules, s 25.
206 Amsterdam Exchanges NV Listing Rules, s 27(c).

changes in ownership or information that may have a significant effect on the price of the shares and of all other information and circumstances of which the public must be informed.[207] Private placements of listed securities that may be converted into shares must be notified to the Amsterdam Exchanges NV.

NMAX. In addition to the disclosure requirements mentioned above, issuers listed on the NMAX must publish quarterly statements with information regarding the issuer.[208] Included must be:

- Auditor's statements (if present);
- Information regarding changes in the holdings of shareholders; and
- The amount of shares and options held by the board and supervisory board.[209]

It is recommended that information regarding turnover, operational results, cash flow, and profit be included. If national accounting principles were used, it is recommended that they be reconciled with International Accounting Standards or United States GAAP. It is recommended to provide an English translation of all annual, semi-annual, and quarterly and other statements.

Unlisted Securities

In General

In addition to any periodic disclosure requirements pursuant to corporate law, which depend on the applicable law to the corporation, issuers of unlisted securities that are not investment undertakings are under periodic disclosure duties under the Act on Supervision of Securities Trade 1995.[210] Therefore, even foreign issuers that do not need to comply with the general corporate publication requirements regarding the annual statement of Book 2 of the Civil Code must publish certain information if they have issued securities outside a closed circle in The Netherlands.

Content Requirements

There are detailed rules regarding what must be disclosed, specified in sections 7–9 of the Decree on the Supervision of Investment Undertakings. Briefly, these requirements entail:

- Drawing up of annual statements within six months after the end of the book year, according to general acceptable standards;[211]

207 Amsterdam Exchanges NV Listing Rules, s 30.
208 NMAX Special Listing Rules, s 9.
209 NMAX Special Listing Rules, s 9.
210 Act on Supervision of Securities Trade 1995, s 5.
211 Act on Supervision of Securities Trade 1995, s 7(2) and (3).

- Drawing up of semi-annual statements within four months after the end of the semi-annual period that must provide information regarding turnover and results before and after tax;[212] and
- Auditing by an accountant of the annual statement.

The auditor's findings must accompany the annual statement. If an auditor audits the semi-annual statements, his findings must accompany those statements.[213] However, issuers that do not have their seat in The Netherlands may have their statements audited by an official who, according to local law, is authorised to do so.[214]

These statements must be in accordance with the Dutch law regarding annual statements found in Book 2 of the Civil Code, if the issuer has its seat in The Netherlands. If the issuer has its seat in another member state of the EU or EEA, the statements must be in accordance with the requirements of Directive 78/660/EEC and Directive 83/349/EEC. If an issuer has its seat outside the EU or EEA, its statements must be according to standards of equal quality. In addition, the statements must specify according to which rules they were drawn up. If the statements are not drawn up according to Dutch law or European law, the Securities Board of The Netherlands, in co-operation with the Minister of Justice, may issue guidelines regarding valuation methods and contents of the statements.[215]

Publication must take place within a week after the annual statements have been adopted by depositing them with the trade registry where the issuer is registered or, if the issuer is not registered in The Netherlands, with the trade registry in Amsterdam.[216] Simultaneously, the statements must be sent to the Securities Board of The Netherlands.

In addition, any significant new information regarding business activities that might influence the price of the issued securities considerably must be published as soon as possible. A copy of the publication must be sent to the Securities Board of The Netherlands.[217]

Exception

There is an exception to the requirement to publish semi-annual statements for issuers whose securities are listed on an exchange in a member state of the EU or EEA if the issuer publishes semi-annual statements in accordance with Directive 82/121/EEC.

Exemptions

Issuers who have only issued securities that are not within the prohibition of section 3(1) of the Act on Supervision of Securities Trade 1995 (ie, if the issued securities have been

212 Act on Supervision of Securities Trade 1995, s 7(4).
213 Act on Supervision of Securities Trade 1995, s 8(2) and (4).
214 Act on Supervision of Securities Trade 1995, s 8(4).
215 Act on Supervision of Securities Trade 1995, s 7(8).
216 Act on Supervision of Securities Trade 1995, s 7(10).
217 Act on Supervision of Securities Trade 1995, s 9.

excepted or exempted from the prospectus requirement) are not under a periodic disclosure requirement.[218]

Investment undertakings that have been exempted from the licence requirement of the Act on Supervision of Investment Undertakings because they only deal with professionals[219] or that have been individually exempted by the Dutch Central Bank, are exempted from the periodic disclosure requirements of the Act on Supervision of Securities Trade 1995.[220]

Finally, the Securities Board of The Netherlands may grant individual exemptions from the disclosure requirements on request.[221] These exemptions may be conditioned or restricted if the adequate functioning of the market or the position of investors so requires.[222]

Investment Undertakings

Disclosure to Public

The investment undertaking must draw up annual statements. If the investment undertaking is not already governed by the relevant rules of Book 2 of the Dutch Civil Code, the relevant sections are applicable through section 19(2) of the Decree on the Supervision of Investment Undertakings (ie, foreign investment institutions must make up their annual statements in accordance with Dutch law). The annual statements must be accompanied by a statement by an auditor to effect that they are true and accurate.[223] Section 21 of the Decree on the Supervision of Investment Undertakings provides detailed rules regarding the contents that are additional to the requirements of Book 2 of the Civil Code. Among these additional requirements is to publish the total personal holdings of members of the board and the total number of 'large investors' that have invested in the investment undertaking or its subsidiaries, as well as the total number and amount of transactions with these 'large investors'.[224]

There are limited exceptions to this requirement (eg, for transactions in listed securities).[225] 'Large investors' are defined as investors that hold, individually or through voting agreements, directly or indirectly, 25 per cent of shares or voting rights of the investment undertaking. In addition, the investment undertaking must make available for participants and send to the Dutch Central Bank semi-annual statements.[226] Detailed content requirements for semi-annual statements are found in section 22 of the Decree on the Supervision of Investment Undertakings.

218 Exemption Regulation, s 10.
219 Exemption Regulation Act on Supervision of Investment Undertakings, s 1.
220 Exemption Regulation of the Act on Supervision of Securities Trade 1995, s 11.
221 Act on Supervision of Securities Trade 1995, s 5(2).
222 Act on Supervision of Securities Trade 1995, s 5(3).
223 Decree on the Supervision of Investment Undertakings, s 18(3).
224 Decree on the Supervision of Investment Undertakings, s 21(3).
225 Decree on the Supervision of Investment Undertakings, s 21(4).
226 Decree on the Supervision of Investment Undertakings, s 20(4).

Publication of the annual statements must take place within four months after the annual statements were drawn up and must take place according to the rules set out in the Civil Code (ie, they must be deposited with the Trade Registry). Participants in the investment undertaking are entitled to a copy without cost. In addition, the undertaking must either send every participant an annual statement or must publish such statement in a national newspaper, specifying the place where its annual statements are available. Simultaneously, the Dutch Central Bank must receive copies.[227]

Finally, the investment undertaking must make available, against payment of costs, the information about it or about the manager and depositary that, according to Dutch law, must be available with the Trade Registry, the conditions its uses, a copy of its licence, and a monthly statement with financial information.[228]

Disclosure to Dutch Central Bank

In addition to the above mentioned, investment undertakings must disclose periodically to the Dutch Central Bank their balance sheet and results, mutations in the capital, and their intrinsic value.[229] The form of these statements and the times at which they must be furnished have been further regulated by the Dutch Central Bank per type of investment undertaking.

The Dutch Central Bank may require the investment undertaking to provide an auditor's statement once a year, unless the auditor makes exceptions, in which case the Dutch Central Bank may require statements more than once a year.[230] Any change in the information filed with the trade registry regarding the investment firm, the manager, or the depositary (in the case of an investment fund) must be notified to the Dutch Central Bank within five days.[231]

Exemptions

According to section 12(3) of the Act on Supervision of Investment Undertakings, the Dutch Central Bank may grant an exemption from any of these requirements, if the investment undertaking shows that it cannot reasonably meet these requirements and the purposes of the Act on Supervision of Investment Undertakings are otherwise sufficiently served.

Proxy Disclosure

The Netherlands does not have special rules for proxy disclosure or solicitation, even though proxies and powers of attorney may be used. However, the charter or articles of as-

227 Decree on the Supervision of Investment Undertakings, s 20(1), (2), and (3).
228 Decree on the Supervision of Investment Undertakings, s 23.
229 Decree on the Supervision of Investment Undertakings, s 17(1).
230 Decree on the Supervision of Investment Undertakings, s 17(3).
231 Decree on the Supervision of Investment Undertakings, s 23(5).

sociation of the corporation may rule out the possibility of proxy solicitation.[232] When soliciting proxies, every shareholder or board is merely bound by the general rules of reasonableness and equity.

Trading Rules

Securities Offerings

In General

Section 3(1) of the Act on Supervision of Securities Trade 1995 prohibits the offering or holding out of an offering of securities through issuance in or from The Netherlands outside a closed circle, unless a prospectus is published. Section 4(1) of the Act on Supervision of Investment Undertakings prohibits the offering of shares in investment undertakings or soliciting or obtaining money or assets for shares in an investment undertaking, in or from The Netherlands, outside a closed circle, unless a licence has been obtained. However, an investment undertaking may 'test the market' if all publications specifically state that a licence from the Dutch Central Bank has not yet been obtained and no draft prospectus or draft conditions are given to the public.[233] Whether an offering of securities falls within these prohibitions depends on four factors, namely:

- Whether the offering concerns securities in the meaning of the Act on Supervision of Securities Trade 1995 or the Act on Supervision of Investment Undertakings (see text, above);
- Whether there is an offering;
- Whether the offering is done in or from The Netherlands; and
- Whether the offering is aimed at a 'closed circle'.

Offering

Section 3(1) of the Act on Supervision of Securities Trade 1995 prohibits the offering of securities through issuance or the holding out of such an offering through advertisements or documents. Although section 3(1) of the Act on Supervision of Securities Trade 1995 only speaks of the offering of shares through issuance, section 3(3) of the Act extends the prohibition to offerings of securities that have not been available in The Netherlands outside a closed circle, even though they have been available outside The Netherlands or have been available inside The Netherlands but only within a closed circle or have only been available in The Netherlands to professionals.

What constitutes an offering or the holding out of an offering is not further specified in the Act on Supervision of Securities Trade 1995, the Act on Supervision of Investment Undertakings, the Explanatory Memoranda to the Act on Supervision of Securities Trade 1995, or the Act on Supervision of Investment Undertakings.

232 Civil Code, Book 2, ss 117 and 227.
233 Dutch Central Bank Circular (14 May 1992).

The main issue has been whether negotiations with a single buyer or a small group of buyers constitute an offering. Apart from the question whether such a buyer or group of buyers may be a 'closed circle' (see text, below), these negotiations also may not constitute an offering. It is generally assumed that negotiating a take-over one-on-one does not amount to an offering.[234]

Especially in context of a merger or acquisition through the sale of shares, the prohibition of section 3(1) of the Act on Supervision of Securities Trade 1995 does not seem to make sense. The Supreme Court has held that, if one offers securities to one person or legal entity, the prohibition of section 3(1) of the Act on Supervision of Securities Trade 1995 does not apply. According to the Supreme Court, there will be sufficient opportunity for the investor to inform himself. According to literature, the same reasoning ought to apply to take-overs involving more than a single investor or buyer.[235] However, the Supreme Court has ruled that an offering need not necessarily be to the public at large to qualify as an 'offering' under the Act on Supervision of Securities Trade 1995. Even if the investor approached the seller before the sale, even if negotiations followed, and even if the seller did not actively advertise the sale, there still may be an offering.[236]

It is not clear whether the Supreme Court reasons that there is a closed circle, or whether there is no 'circle', or whether it means that there is no offering. Therefore, although it is clear that one-on-one negotiations are outside the prohibition of section 3(1) of the Act on Supervision of Securities Trade 1995, it is not yet clear whether small group negotiations are prohibited. Much will depend on the circumstances.

Closed Circle

In General. The structure of the Act on Supervision of Securities Trade 1995 and the Act on Supervision of Investment Undertakings is that all offerings that are not limited to a closed circle are within the scope of the Acts. The phrase 'closed circle' has not been defined. However, the Explanatory Memorandum to the Act on Supervision of Securities Trade 1995 gives some guidance for interpreting what a 'closed circle' is. Firstly, the Minister of Finance has remarked that the phrase should be construed narrowly.[237] Secondly, the Minister gave three specific considerations to determine whether there is a closed circle, even though all circumstances may be relevant, namely:

Limited in Number and Clearly Defined. The group of people to which the securities are offered must be limited in number and clearly defined. However, there seems to be no maximum number of people that may constitute a 'closed circle' for purposes of the Act

234 Van Dijk, 'De Wet Toezicht Effectenverkeer in vogelvlucht', *TVVS* (1991), no 91/8, at p 205.
235 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 172.
236 Supreme Court, *Tjoeroeg*, 17 December 1996, *JOR* (4 February 1997/1), at pp 65 and 66; Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 172.
237 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at p 202.

on Supervision of Securities Trade 1995. At least for employee share option plans, the Securities Board of The Netherlands does not impose a maximum.[238]

In a recent Circular, the Securities Board of The Netherlands explained its opinion on the 'closed circle' criterion.[239] The Board stated that admission to a group must be limited for a group to meet the 'limited numbers' criterion.

Additional Relationship between Offeror and Offerees. There must be an additional, legal,[240] relationship between the offeror or issuer and the group of people to which the securities are offered. In other words, there must be a relationship in addition to 'the financial relationship of the offering'.[241] An example is the offering of securities to employees. This group is both limited and well defined. There also is an additional relationship. However, any additional relationship may not be sufficient. Thus, the offering of stock dividends to stockholders where the number of stockholders is very large, resulting in not more than an anonymous financial relationship, may not be enough. There are some writers who claim it is generally assumed that the additional relationship may not be financial at all.[242]

In principle, the additional relationship must exist between the offering person or institution and the investor.[243] There has been criticism on this narrow interpretation in literature, especially when investment funds for employees are involved. If the fund is separate from the employer, there will not be an additional relationship between offeror and investor, and thus the closed circle exception would not apply.[244] In response to this criticism, the Securities Board of The Netherlands adopted the policy that offerings by corporations that are part of a group to employees from other corporations within that group are within a 'closed circle'. Likewise, offerings by investment funds for employees are within a 'closed circle' if the investment fund is closely related to the corporation.

Presentations of Offering Explicitly Limited to Members of Closed Circle. In presenting the offering, it must be made clear that only members of the limited and narrowly circumscribed group may respond.[245]

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238 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 170.
239 Circular 98-001, Securities Board of The Netherlands.
240 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 171.
241 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at p 200.
242 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 171.
243 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at p 200.
244 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 171.
245 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at p 137.

Differences for Investment Undertakings. There are some minor differences with regard to investment undertakings. Firstly, the Explanatory Memorandum to the Act on Supervision of Investment Undertakings mentions the three factors discussed above, but it seems to add a fourth: that access to the closed circle must be limited. There is some discussion whether this is a separate requirement that must be fulfilled to be able to speak of a 'closed circle' or whether limited access logically follows from the first requirement that the group of people be limited and clearly defined.[246]

There also is a practical difference in the interpretation of what constitutes a closed circle between the Securities Board of The Netherlands for the Act on Supervision of Securities Trade 1995 and the Dutch Central Bank for the Act on Supervision of Investment Undertakings. While the Securities Board of The Netherlands has not imposed a maximum number of people that will always constitute a closed circle, the Dutch Central Bank does seem to work with numbers. According to one writer, the Dutch Central Bank considers a group of less than 10 persons a closed circle, regardless of the three requirements mentioned above.

Groups of more than 50 people will need to know each other to constitute a closed circle, in addition to the three requirements mentioned above. Groups of between 10 and 50 need only comply with the three requirements set out above.[247] It should be noted that the Dutch Central Bank has not issued any guidelines in this respect, and it has not committed itself to any course of action. It will consider whether a closed circle exists on a case-by-case basis.

Place of Offer

Section 3(1) of the Act on Supervision of Securities Trade 1995 and section 4(1) of the Act on Supervision of Investment Undertakings are applicable to all offerings 'from or in The Netherlands'. There is no doubt that offerors that have their seat according to their charter or articles of association in The Netherlands fall within the prohibition of section 3(1) of the Act on Supervision of Securities Trade 1995 and section 4(1) of the Act on Supervision of Investment Undertakings. The Explanatory Memorandum to the Act on Supervision of Investment Undertakings states that all 'investment undertakings that have their (statutory) seat in The Netherlands' fall within the purview of the Act on Supervision of Investment Undertakings. Doubts may rise whether an investment undertaking that has its factual seat or a branch in The Netherlands, but offers its securities exclusively outside The Netherlands, is within the purview of the Act on Supervision of Investment Undertakings.[248]

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246 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 169.

247 Corten, 'Het Element besloten kring in de Nederlandse Effectenwetgeving', *TVVS* (1997), no 97/6, at p 170.

248 The same problem does not exist for offerors of securities that are not investment undertakings because the Act on Supervision of Securities Trade 1995 prohibits only offerings in The Netherlands, whereas the Act on Supervision of Investment Undertakings prohibits the acceptance of money and goods, as well.

The use of parenthesis in the Explanatory Memorandum to the Act on Supervision of Investment Undertakings suggests that investment undertakings that have their factual seat in The Netherlands would have to comply with the Act on Supervision of Investment Undertakings, as well. Whether an investment undertaking that has a branch office in The Netherlands, but offers its securities exclusively abroad, is regulated by the Act on Supervision of Investment Undertakings is unclear. However, considering the purpose of the Act on Supervision of Investment Undertakings (ie, the protection of investors in The Netherlands), such investment undertakings are probably outside the prohibition of section 4(1) of the Act. For the Act on Supervision of Securities Trade 1995. the issue is solely whether the offer is made from The Netherlands. In other words, if the offeror is acting from The Netherlands, the Act on Supervision of Securities Trade 1995 will be applicable.

Clearly, if one advertises for an offering in Dutch newspapers, the Act on Supervision of Securities Trade 1995 or the Act on Supervision of Investment Undertakings will apply. Likewise, if the offering is solely aimed at investors in The Netherlands, even though the chosen medium may be crossborder, one will be offering in The Netherlands. However, if one advertises in crossborder media for a multinational offering, the applicability of the Act on Supervision of Securities Trade 1995 or the Act on Supervision of Investment Undertakings is less clear. In the Explanatory Memorandum to the Act on Supervision of Investment Undertakings, the Minister of Finance has said that the purpose of the Act is that offerings of securities of investment undertakings traded in The Netherlands are possible only when a licence has been obtained by the investment undertaking.

This points to a broad view of applicability for both the Act on Supervision of Investment Undertakings and, analogously, the Act on Supervision of Securities Trade 1995. The fact that a person in The Netherlands buys securities from an issuer outside The Netherlands may easily give rise to a charge of offering securities in The Netherlands, even when the offeror is located outside The Netherlands. This is the more so now that there are several exceptions from the prospectus requirement for offerors from other countries within and without the EU and EEA (see text, above).

Suggestions have been made for connecting factors to determine whether an offer is made in The Netherlands. Thus, whether the offering or the holding out is in the Dutch language, whether the advertisements are placed in Dutch newspapers or newspapers that are distributed in The Netherlands, whether there is an office or person in The Netherlands for investors to turn to, and whether there are telephone numbers aimed at Dutch investors could influence a determination that the offering was ‘in The Netherlands’.

Secondary Trade

In The Netherlands, there is no regulation of secondary trade in unlisted securities. Thus, the Act on Supervision of Securities Trade 1995 does not apply to secondary trade, unless the traded securities were not previously available outside a closed circle in The Netherlands.[249] Once securities are introduced with a prospectus, because their first-time offering was within the purview of the Act on Supervision of Securities Trade 1995, the secondary trade in these securities is unregulated.

Listed Securities

Amsterdam Exchanges NV has some regulations with regard to the technicalities of the trade in securities. Thus, for first-time introductionsthe — there is a Circular of Amsterdam Exchanges NV regarding the stabilisation of prices after a first-time introduction.[250] With regard to the manner of offering securities that are or will be listed on the Amsterdam Exchanges NV, Amsterdam Exchanges NV has issued Circular R95-020, regarding book-building, that contains some regulations and considerations.

There also is an Amsterdam Exchanges NV Circular concerning non-public offerings (*onderhandse plaatsing*) of securities listed on the Amsterdam Exchanges NV Official Market.[251] According to Circular R94-029, there are publication requirements regarding the essentials (ie, issuer, buyer, amount, manner of pricing, manner of placement, and possible discounts) of the placement. In addition, there is a Circular with regard to the use of book-building for first-time introductions on Amsterdam Exchanges NV.[252]

Disclosure of Acquisition of Substantial Holdings

In General

The Major Holdings Disclosure Act (*Wet Melding Zeggenschap*) covers both securities listed on an exchange in The Netherlands, and securities listed on exchanges in other member states of the EU or EEA. The Major Holdings Disclosure Act is applicable when the issuer is a corporation under the law of The Netherlands that is listed on an officially recognised exchange in an EU or EEA member state. Duties similar to those of the Major Holdings Disclosure Act are imposed on issuers listed on Amsterdam Exchanges NV that do not fall under the Act.[253]

Shareholder's Duty

Under the Major Holdings Disclosure Act, the investor can be a natural person or a legal entity. However, partnerships or limited partnerships are not regarded as shareholders under the Major Holdings Disclosure Act, although their partners are within the scope of the Act.[254]

The investor who acquires or disposes of shares of or voting rights in a listed corporation and who is aware, or should be aware, of the fact that such acquisition or disposal results in a crossing of certain threshold percentages of ownership in the issuer, must notify both the corporation and the Securities Board of The Netherlands.[255]

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250 Amsterdam Exchanges NV, Circular R95-010 (21 July 1995).
251 Amsterdam Exchanges NV, Circular R94-029 (29 November 1994).
252 Amsterdam Exchanges NV, Circular R95-020 (7 November 1995).
253 Amsterdam Exchanges NV Listing Rules, s 28(f).
254 Major Holdings Disclosure Act, s 4(4).
255 Major Holdings Disclosure Act, s 2.

Acquisition of shares or voting rights, in this context, must be read in its broadest sense; it includes every form of direct or indirect holding of shares or voting rights or potential shares or voting rights. It includes the holding of the shares by the investor (or its subsidiary) or by a third party that holds the shares for the account of the investor. It also includes the holding of voting rights that can be exercised in connection with shares that are held directly, in usufruct, or that are pledged by the investor or by a third party for the account of the investor, or by virtue of a voting agreement.[256]

Shares or voting rights include potential shares or voting rights or depository receipts of shares (*certificaten*).[257] Potential shares or voting rights are agreements on the basis of which shares or voting rights can be acquired (eg, call options, warrants, or convertible bonds and the right to buy future shares or shares that are not yet issued).[258]

Any acquisition or alienation of shares or voting rights in a corporation must be notified if it causes the percentage of voting rights or shares of the investor to cross one of several thresholds. The Major Holdings Disclosure Act 1996 has determined five such thresholds, ie, five per cent, 10 per cent, 25 per cent, 50 per cent, and 662/3 per cent.[259] Only the crossing of a threshold caused by an acquisition or alienation of shares or voting rights in the company leads to the obligation of disclosure. A crossing of a threshold caused by an emission or withdrawal of capital is not subject to the rules set forth in the Major Holdings Disclosure Act.

Notification must be done immediately after the signing of the purchase agreement of shares or voting rights.[260] This need not necessarily coincide with the moment of actual transfer of shares or voting rights. Whichever moment comes first in time is decisive. In addition, the investor who acquires, or holds, more than five per cent of the shares of or voting rights in a corporation that is newly admitted to an exchange in an EU or EEA member state must disclose his holding in this corporation. Disclosure must be done within four weeks after the date of admittance.[261]

Exemption

The Major Holdings Disclosure Act grants an exemption from the disclosure requirement to certain investment undertakings that, in the conduct of their profession or business, hold shares for a period no longer than three months. This exemption is not applicable if the investment institution uses the shares or voting rights to vote or otherwise determine the policy of the issuer.

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256 Major Holdings Disclosure Act, s 4.
257 Major Holdings Disclosure Act, s 1(3).
258 Perrick, 'De nieuwe Wet melding zeggenschap', *TVVS* (1997), no 97/4, at p 97.
259 There is a less strict rule for large investment corporations with constantly changing capital, as referred to in section 76a of Book 2 of the Civil Code. Applicability of the 'regular' thresholds of the Major Holdings Disclosure Act would lead to constant notification with regard to these corporations. For these companies, a special regime of only three thresholds is established, ie, 25 per cent, 50 per cent, and 66$^{2}/_{3}$ per cent.
260 Major Holdings Disclosure Act 1996, s 2.
261 Major Holdings Disclosure Act, s 3.

Consequences of Violation of Major Holdings Disclosure Act

Breach of the obligations under the Major Holdings Disclosure Act 1996 constitutes a criminal offence.[262] The investor risks a maximum sentence of two years' imprisonment or a fine of NLG 25,000 if he is a natural person, or a fine of NLG 100,000 if a legal entity.

In addition, the corporation, or one or more shareholders that represent in total at least one-twentieth of the issued capital of the corporation, can apply to the court on the basis of section 9 of the Major Holdings Disclosure Act to:

- Order the investor to comply with the Major Holdings Disclosure Act;
- Order the suspension of the voting rights on the holding of the delinquent shareholder for a maximum period of three years;
- Annul specific shareholders' resolutions that probably would not have been adopted but for the votes of the delinquent shareholder;[263] or
- Enjoin the delinquent shareholder from obtaining shares or voting rights in the corporation for a maximum period of five years.

These measures, except for the annulment of shareholder resolutions, also can be claimed in summary proceedings.

Publication

Between five to nine days after notification, the Securities Board of The Netherlands must publish:

- The name, address, and residence of the holder of the shares or voting rights;
- The name of the corporation;
- The relevant percentage of shares or voting rights;
- The composition of the holding (eg, shares, voting rights, and optional shares); and
- The date of the change in percentage.

Publication must be done in a daily national newspaper of every EU and EEA member state where the corporation is listed on an exchange.[264] The listed company involved may ask the Securities Board of The Netherlands to refrain from publication if publication can harm the public interest or lead to serious damages for the issuer.[265]

Insider Trading and Fraud

262 Act on Economic Offences, s 1(2).
263 The court may order the suspension of such shareholders' resolutions while the case is pending.
264 In The Netherlands, publication is done in the national newspaper *Het Financieel Dagblad*.
265 Major Holdings Disclosure Act, s 7.

Applicable Rules

Insider trading and other forms of securities fraud are governed by various European Regulations, the European Convention on Insider Trading, the Act on Supervision of Securities Trade 1995, the Act on Economic Offences, and the Dutch Criminal Code.

Insider Trading under the Act on Supervision of Securities Trade 1995

'Insider Trading', as prohibited under section 46 of the Act on Supervision of Securities Trade 1995, is defined as any transaction in listed securities, or soon to be listed securities, or in securities that derive their value from (soon to be) listed securities that is performed or realised with inside information. 'Inside information' is defined as familiarity with a special circumstance regarding the legal entity, company, or institution which securities it concerns or regarding the trade in securities:

- That has not been made public; and
- The publication of which can reasonably be expected to influence the price of the securities concerned, without regard to the direction of the influence on the price.

Examples of 'special circumstances' are the knowledge of exceptionally good or exceptionally bad company results or knowledge of an upcoming take-over. Dutch case law in this area is so rare that few guidelines can be given as to what information will be covered by this part of section 46 of the Act on Supervision of Securities Trade 1995.

A definition of 'public' under section 46 must take into account that information can be publicly available without actually being absorbed by the public. Alternatively, information which was originally intended to remain secret can become public through a leak. If secret information has, in fact, become common knowledge among those in the securities industry, it is no longer considered non-public.

There are certain kinds of conduct that, although generally considered acceptable in the securities markets, would formally fall within section 46 of the Act on Supervision of Securities Trade 1995.

To prevent this, paragraphs 3 and 4 of section 46 provide that the prohibition of the first paragraph is not applicable to several categories of persons or transactions. Section 46(3) exempts the following persons:

- The intermediary who possesses inside information regarding the trade in securities and who acts in accordance with the rules of good faith as an agent for his principals;
- The entities (eg, banks) of which the employees and those involved in the transaction only have inside information with regard to the trade; and
- Those who perform a transaction to comply with an enforceable obligation which existed at the time they received the inside information.

Pursuant to section 46, paragraph 4, of the Act on Supervision of Securities Trade 1995, the following transactions are exempted:

- The granting, pursuant to an employee stock option plan, of options of convertible bonds, warrants, and comparable rights, if the Securities Board was informed of the intention to grant two months before the grant;
- The exercising of an option under an employee stock option plan on the expiration date or within five working days preceding the expiration date, and the immediate sale of the securities obtained by the exercise if the exercising person informed the company of the intention to sell two months before the expiration date;
- Transactions that are necessary to comply with enforceable obligations to deliver shares or depository receipts;

- Transactions performed to stabilise the price of securities in a public offering by the securities institution concerned, if the intention to perform stabilising measures was announced in the prospectus;
- Underwriting a public offering; and
- Issuing stock dividends.

The above-mentioned exempted transactions do not violate the prohibition of insider trading, even if one party or both parties have inside information at the time of the transaction.

Section 46a of the Act on Supervision of Securities Trade 1995 prohibits passing on inside information to a third party or, while having knowledge of inside information, advising a third party to perform certain transactions, unless this occurs in the normal line of duty (eg, a press officer whose job it is to make information public). The prohibition to advise does not apply to entities (eg, banks) of which the employees involved in such advise themselves do not have inside information.

Section 46b requires each issuer of listed securities to report its transactions in its own securities. It also contains obligations for its managers, supervisory directors or others in charge, and persons with easy access to inside information to immediately report to the Securities Board of The Netherlands any transaction in the company's securities.

Section 46c of the Act on Supervision of Securities Trade 1995 requires the Minister of Finance to issue an official list of these transactions. Section 46d contains the obligation for issuers of listed securities to adopt regulations in which rules are laid down with regard to the possessions of and transactions in their securities by their employees, managers, supervisory directors, and others in charge. Such a regulation is commonly referred to as a 'Model Code'.

According to a regulation of the Minister of Finance, the Model Code should at least contain provisions regarding:

- The tasks and responsibility of the compliance officer, if there is a compliance officer;

- The duties of employees, managers, supervisor directors of others in charge, and shareholders of more than 25 per cent of the outstanding capital, regarding the possession of and transactions in the company securities; and
- The period in which no transactions may be performed by these persons.

The company must send the Model Code and its amendments to the Securities Board of The Netherlands.

International Aspects

Section 46(2) of the Act on Supervision of Securities Trade 1995 makes it illegal to cause a transaction to be concluded with inside information in The Netherlands, as well as from The Netherlands. This prohibition concerns both Dutch exchanges and foreign exchanges admitted by the relevant government. As far as transactions in securities listed or soon to be listed at the Amsterdam Exchanges NV stock exchange are concerned, it is irrelevant whether these are performed or realised by a person inside or outside The Netherlands. Both situations are covered by section 46(2).

For foreign exchanges, the place of the transaction may be important. The phrase 'in or from The Netherlands' refers to the place where the transaction takes place or is caused to take place, not the place where the person who actually transacts or causes the transaction to take place is located.

Consequences

Violation of section 46a, 46b, 46c, or 46d of the Act on Supervision of Securities Trade 1995 is punishable by a fine of a maximum of Dfl 100,000 or imprisonment of two years (in case of an individual) and a fine of up to NLG 1 million (for companies). Among possible additional measures are (partial) shut down of a company's activities, confiscation of certain rights, denial of certain benefits, and publication of a conviction.

Deception of the Public

Section 47 of the Act on Supervision of Securities Trade 1995 prohibits the inducements of the public's subscription or participation by purposely withholding or falsifying certain information, usually through the prospectus. Section 47 only refers to the primary issuing of securities.

Price Manipulation

Section 334 of the Criminal Code prohibits deception of the public. It concerns the purposeful spreading of false information by a person for his own benefit, to influence the price of securities. Where information regarding securities on the secondary market is withheld or falsified, section 334 may be applicable.

Public Bids

In General

Public bids in The Netherlands are regulated mainly by the Socio-Economic Council Merger Code of Conduct (hereinafter, the 'Merger Code'). The Merger Code does not have force of law but is a code of conduct. In February 1996, the Socio-Economic Council proposed giving the Merger Code a legal basis but, to date, no legislation has been enacted.[266]

Chapter I of the Merger Code contains the rules with regard to the protection of shareholders in case of a public bid. Chapter II contains the rules with regard to notification and with regard to consultation with the trade unions in case of a merger. Chapter III contains the rules with regard to notification of the Minister for Economic Affairs in case of a merger. Chapter IV contains the constitution and the procedure of the Socio-Economic Council Committee for Merger Affairs, and chapter V contains some final provisions.

The rules contained in the Merger Code are generally followed by parties in public bids in The Netherlands. This is due to the fact that non-compliance with the Merger Code may constitute an act of tort. Furthermore, if the Merger Code is not followed, the Committee for Merger Affairs may make a public announcement or issue a public rebuke.[267]

Such an announcement or rebuke is considered bad publicity for the company or the companies concerned. In case of a public rebuke of a party involved in a public bid, all securities institutions admitted to the Amsterdam Exchanges NV are forbidden by the Amsterdam Exchanges NV to render any further services with regard to the public bid concerned. This will result in considerable difficulties for the bidder, especially with regard to the completion of the bid, as one or more of such securities institutions normally act as advisors to the transaction.

Territorial Application

Chapter I of the Merger Code applies if a public bid is made by a Dutch corporation (hereinafter the 'bidder')[268] for the shares of another Dutch company (hereinafter the 'target'), if the shares in the latter are listed on the Amsterdam Exchanges NV or not listed but regularly traded in The Netherlands.[269]

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266 On 7 February 1996, the European Commission introduced the revised text of the proposed Thirteenth Directive on Company Law, providing for uniform regulation of public bids in the European Union. If enacted, the draft Directive would require two changes in Dutch merger regulations, namely: bidders who have acquired a specific percentage of the target's shares, giving control of the target, would be required to make a public bid for the shares held by the remaining shareholders in the target or take other means to protect such shareholders; and after a bid has been made, the target would be barred from adopting anti-take-over devices without shareholder approval.

267 Merger Code, s 32(1).

268 A corporation is an 'NV' (public corporation) or a 'BV' (closed corporation), as referred to in Book 2 of the Civil Code.

269 Merger Code, ss 1(1) and 2(1).

If the bidder is not a Dutch corporation,[270] the Merger Code must correspondingly be applied as far as possible, irrespective of the bidder's legal form and nationality.[271] A foreign bidder, therefore, should take the Merger Code into account when considering a public bid on a Dutch corporation.

If the target is a foreign corporation and the bidder is a Dutch corporation whose shares are listed on the Amsterdam Exchanges NV, or not listed but regularly traded in The Netherlands, the Merger Code applies in part.[272]

For example, the rules concerning the public announcement of the bid must be followed. Chapter I of the Merger Code also applies when a non-public bid is directed towards the shares of more than 50 per cent of the shareholders in the target as appearing from the shareholders' register.[273]

The Merger Code applies to 'friendly' bids and 'hostile' bids alike. Although attempts have been made, no hostile public bid has been successful in The Netherlands. This is probably due to the fact that a large majority of the Dutch-listed companies and non-listed companies have adopted adequate anti-take-over measures.[274]

Procedural Requirements

The Merger Commission recognises three kinds of public bids,[275] namely:

- A fixed bid, which is a public take-over bid to all the shareholders in the target stating at least the offered price or the share exchange ratio in case the bidder offers to issue shares in exchange for the shares in the target;
- A partial bid, which is a public bid to acquire a limited portion of shares in the target;[276] and
- A tender offer, which is a public invitation to the holders of the shares in the target to tender their shares for a consideration to be stated by the holders of such shares.[277]

Fixed bids are the most frequent. The procedure for a fixed bid is described below in a more or less chronological order.[278]

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270 This might be a Dutch entity not having the legal form of an NV or a BV or a foreign entity.
271 Merger Code, s 2(3).
272 According to section 2(5) of the Merger Code, sections 3, 10, and 13 must be observed.
273 Merger Code, s 2(2).
274 A statute which will enable a bidder to set aside such devices under specific circumstances is in preparation, *Kamerstukken* II, 25732; see text, above.
275 Merger Code, s 1(1).
276 A partial bid is permitted if the bidder does not acquire more than 30 per cent of the shares in the target, including the shares the bidder already owned prior to the bid. Merger Code, s 6A(1)(f).
277 The 30-per-cent rule applicable to partial bids equally applies to tender offers. Merger Code, s 6B(1)(f).
278 A merger resulting from a public bid may result in an impairment of free competition. Therefore, Dutch or European competition law often applies.

The bidder and the target are under an obligation to make a public announcement without delay if circumstances occur which require a public announcement to prevent insider trading.[279] For example, such a public announcement is required if the negotiations between the bidder and the target reach a stage where the expectation is justified that an agreement on the bid can be reached; such an announcement must state at least this circumstance and the names of the bidder and the target.[280] A public announcement also is required when definitive agreement on the price or exchange ratio is reached.[281]

In the event of a hostile bid, the bidder is under the obligation to consult with and to inform the management of the target before publicly announcing the price or share exchange ratio.[282] If a public announcement concerning a public bid is made, the trade unions must be informed in advance of the content of such an announcement.[283] If the expectation is justified that an agreement on the merger can be reached, the bidder and the target are under the obligation to inform and subsequently consult the trade unions on the anticipated bid.[284] Furthermore, the bidder and, in case of a friendly bid, the target have an obligation to give their respective works councils an opportunity to give advice on the proposed bid and subsequent take-over.[285]

If a public announcement has been made that the expectation is justified that an agreement can be reached between the bidder and the target or the target is notified of the bidder's intention to make a public bid, the bidder, within 30 days, must:

- Make a public bid;
- Announce the decision not to make the public bid; or
- Announce an indication of the period in which a decision about the public bid may be expected.[286]

The bidder is under an obligation to make available an offer to purchase. The availability of the offer to purchase must be made public by an announcement in the *Prijscourant* or by way of a further announcement in the national press, stating at least the price or the share exchange ratio.[287] An offer to purchase must be available within six weeks of such an announcement.[288] The offer to purchase must contain information on:

- The bidder;
- The target;
- The price or share exchange ratio;

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279 Merger Code, s 3(1). Companies listed on the Amsterdam Exchanges NV are under the obligation to immediately make a public announcement of information that should be considered to influence the price of securities significantly (see section 28(h) of the Listing Rules, which is triggered independently from the obligation of section 3(1) of the Merger Code).
280 Merger Code, s 3(2)(a).
281 Merger Code, s 3(2)(d).
282 Merger Code, s 4.
283 Merger Code, s 17.
284 Merger Code, s 18.
285 This obligation is laid down in section 25 of the Works Councils Act (*Wet op de Ondernemingsraden*).
286 Merger Code, s 5(1).
287 Merger Code, s 5(3).
288 Merger Code, s 5(4).

- The circumstances on which the take-over bid is made conditional;[289]
- The outcome of the discussions between the bidder and the target;
- The bidder's plans concerning the target;
- The cross-participations between bidder and target; and
- Whether shares in the target have been acquired by the bidder from officials of the target and their families in the three years prior to the offer to purchase.[290]

The managements of the bidder and the target are responsible for the information concerning their respective companies contained in the offer to purchase.[291] According to section 8 of the Merger Code, information on trading in the shares of the target by officials of bidder and target, and their respective families, in the period of six months before the first public announcement must be submitted to the Committee for Merger Affairs.

The tender period, the period during which the bid may be accepted, commences the first day after the offer to purchase is made available.[292] The tender period may not be less than 20 days if the bid is friendly. In the case of a hostile bid, the tender period may not be less than 30 days.[293] The target is under an obligation to convene a general meeting of shareholders to inform the shareholders about the bid at least eight days before the end of the tender period.[294] However, no shareholders' decision is required with regard to the intended bid. If the bidder offers to issue shares of up to a nominal value of more than one-quarter of the bidder's issued capital in exchange for the shares in the target, the bidder is under an obligation to convene a general meeting of shareholders, as well.[295] This obligation almost certainly does not apply to foreign bidders.

With some exceptions, most of the procedural rules that apply to fixed bids apply to partial bids and tender offers as well. Some of the more important exceptions are:

- In the case of a hostile partial bid or tender offer, the obligation to inform the management of the target does not include the obligation to inform regarding business policies of the bidder with regard to the target;[296]
- An offer to purchase is not required;[297] and
- In the case of a partial bid or tender offer, the tender period may not be less than seven days.[298]

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289 Conditions the fulfilment of which are dependent on the will of the bidder are not permitted. Merger Code, s 11(1).
290 Merger Code, s 6(1).
291 Merger Code, s 6(2).
292 Merger Code, s 7A(1).
293 Merger Code, s 7A(2).
294 Merger Code, s 9(1).
295 Merger Code, s 10.
296 Merger Code, ss 4A and 4B.
297 Partial bids and tender offers are made by means of a public announcement. The information to be included in such an announcement differs from the information to be included in an offer to purchase. The contents of such an announcement in case of a partial bid also differ from the contents of such an announcement in case of a tender offer. Merger Code, ss 6A and 6B.
298 Merger Code, s 7B(2).

Irrespective of the kind of public bid, the bidder is required to announce whether a public bid will be consummated no later than the fifth trading day following the end of the tender period.[299] If the bid is consummated, the bidder is not allowed to acquire shares in the target on terms more favourable than those of the public bid for a period of three years after the Offer to Purchase has been made available.[300] There are some exceptions to this prohibition, such as shares acquired by regular trading on the stock exchange or by way of a squeeze out procedure.

Jurisdictional Conflicts

In General

There are no separate rules for situations where Dutch securities laws and regulations collide with foreign securities laws and regulations. Where there are specific rules, they have been discussed in detail in the substantive sections above. The general system is that any issuer, securities institution, investment undertaking, or other institution that wishes to enter the Dutch market must comply with the Dutch securities laws and regulations. However, especially for issuers, securities institutions, and investment undertakings from EU or EEA member states, there are exceptions and exemptions from requirements.

For non-member states of the EU or EEA, there generally are no specific exceptions or exemptions. However, issuers, securities institutions, and investment undertakings from these countries may use the individual exemptions provided for in most Dutch securities legislation, often specifically to accommodate these situations.

Multilateral Approaches

Substantive Law Solutions

A clear example of a multilateral approach is the legislation of the EU. The law regarding securities in the EU and EEA is harmonised to a large extent.

Procedural Solutions

In addition to substantive rules having been harmonised to a large extent, most EC Directives in the field of securities (eg, the Investment Services Directive and the Prospectus Directives) provide for the recognition in other member states of several documents and licences issued by member states. Thus, once a securities institution is licensed in a member state of the EU or EEA, it may obtain a European passport to provide services in other member states of the EU or EEA. Likewise, a prospectus used for the offering of securities in one member state must be recognised by other member states if it meets the requirements of the relevant Directives.

299 Merger Code, ss 11(3) and 11A.
300 Merger Code, s 12.

Unilateral Approaches

Both the Act on Supervision of Securities Trade 1995 and the Act on Supervision of Investment Undertakings provide for the possibility of individual exemptions.[301]

According to the Explanatory Memorandum of the Act on Supervision of Securities Trade 1995, the possibility of an individual exemption from the prospectus requirements is specifically meant for situations where foreign laws and regulations would be incompatible with Dutch laws and regulations.[302] Thus, where no exception or exemption is specifically created to accommodate foreign securities institutions, the possibility of individual exemptions will have to be used.

301 Act on Supervision of Securities Trade 1995, s 4(1); Act on Supervision of Investment Undertakings, s 5(3).

302 Grundmann-Van der Krol and van den Ingh, *Parlementaire Geschiedenis van de Wet Toezicht Effectenverkeer 1995* (1996), at p 222.

New Zealand

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New Zealand

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Introduction

Regulatory System

In the 1980s, the New Zealand government substantially deregulated New Zealand's financial markets. These are now relatively free of controls and relatively light-handed in terms of compliance costs.[1]

The light-handed approach adopted in relation to New Zealand's financial markets is reflected in New Zealand's disclosure-based approach to regulation of securities markets.

The collapse of a significant number of finance companies, beginning in 2006, focused the government's attention on the lack of regulation in relation to finance companies. As a result of this, the role and functions of New Zealand's Securities Commission came under close scrutiny. This brought about the establishment, in 2011, of a new super regulator, the Financial Markets Authority.

Legal Sources

Important sources of securities regulation in New Zealand are the following:

- The Securities Act 1978 (and Securities Regulations 2009), which regulates the offer and allotment of securities to the public, most importantly by requiring prospectuses and investment statements, restricting the content of advertisements and, in some cases, requiring the appointment of a trustee or statutory supervisor;[2]
- The Financial Markets Authority Act 2011, which established the Financial Markets Authority and provides the Financial Markets Authority's main

1 This chapter on New Zealand securities regulation is an overview of the relevant law as at the time of writing. Because, by necessity, it is generalised and a summary, and the law may be amended at any time, the reader should not treat any material in this chapter as legal advice. If expert advice on New Zealand securities laws is required, the reader should consult a New Zealand lawyer experienced in securities regulation.

2 Issuers can be relieved from the requirements of the Securities Act and Regulations by exemptions granted by the Financial Markets Authority.

objectives and functions as well as general information-gathering and enforcement powers;

- The Securities Trustees and Statutory Supervisors Act 2011, which requires persons that wish to be appointed as a trustee or statutory supervisor, in respect of a security or retirement village, to apply to the Financial Markets Authority for a license to do so;
- The Securities Markets Act 1988, which imposes liabilities for insider trading, tipping, market manipulation and dealing, and misconduct in respect of securities, requires disclosure of substantial and directors' and officers', interests in listed issuers' securities, regulates dealing in futures contracts, regulates securities exchanges, and requires continuous disclosure by public issuers;
- The Securities Transfer Act 1991, which provides methods for transferring securities;
- The Companies Act 1993, which regulates the issue of shares, transfer of shares, powers and duties of directors, disclosure, and registration of overseas companies in New Zealand;
- The Financial Reporting Act 1993, which requires companies to prepare and, in some cases, have audited (and overseas companies carrying on business in New Zealand and issuers to file) financial statements that comply with generally accepted accounting practice and give a true and fair view of their affairs;
- The Takeovers Act 1993 (and the Takeovers Code Approval Order 2000), which established a Takeovers Panel and the Takeovers Code;[3]
- The Overseas Investment Act 2005 (and Overseas Investment Regulations 2005), which regulates significant investments in sensitive land or significant business assets in New Zealand by overseas persons;
- The Commerce Act 1986, which regulates acquisitions which have the effect of substantially lessening competition in a market, as well as various restrictive trade practices;
- The NZSX/ NZDX Listing Rules, which apply to issuers of securities listed on the NZX and regulate the spread of ownership, the immediate release of price-sensitive information, continuous disclosure and periodic release of specified information, issues and buy backs of securities, transactions with related parties, major transactions, and contents of constitutions;[4]
- The New Zealand Exchange Limited ("NZX") Regulations, which constitute a statement of required practice for members of the NZX, in respect of the conduct of members and the conduct and administration of business on the NZX;

3 The Takeovers Panel may grant exemptions from the requirements of the Takeovers Code.

4 The NZX also conducts market supervision.

- The Financial Advisers Act 2008, which requires financial advisers and brokers to take care in providing services to investors and consumers and certain conduct by financial advisers and brokers, including by requiring certain advisers to be authorised and comply with the Financial Advisers (Code of Professional Conduct for Authorised Financial Advisers) Notice 2010;
- The Financial Service Providers Act (Registration and Dispute Resolution) Act 2008, which requires financial service providers to be registered and be part of a dispute resolution scheme;
- The Financial Advisers (Code of Professional Conduct for Authorised Financial Advisers) Notice 2010, which imposes a code of practice on authorised financial advisers;
- The Anti-Money Laundering and Counter Financing of Terrorism Act 2009, which facilitates co-operation amongst reporting entities, AML/CFT supervisors, and various government agencies to detect and deter money laundering and the financing of terrorism;
- The Unit Trusts Act 1960, which regulates unit trusts (in some countries called 'mutual funds');[5]
- The KiwiSaver Act 2006, which establishes the rules for New Zealand's subsidised retirement savings regime;
- The Superannuation Schemes Act 1989, which provides for the registration of superannuation schemes and regulation of registered schemes;
- The Trustee Companies Act 1967, which regulates companies defined as 'trustee companies' for the purposes of the Act and group investment funds;[6]
- The Partnership Act 1908, which regulates the nature of partnerships, relations between partners and between partners and persons dealing with them, and dissolution of partnerships;
- The Insurance (Prudential Supervision) Act 2010, which establishes a licensing system for insurers, imposes prudential requirements on insurers, provides for supervision by the Reserve Bank of New Zealand of insurers, and confers certain powers on the Reserve Bank of New Zealand to act in respect of insurers in financial distress or other difficulties;
- The Life Insurance Act 1908, which regulates aspects of life insurance policies;

5 The Unit Trusts Act 1960 is generally regarded as applying only to unit trusts established in New Zealand.

6 Trustee companies, in turn, may act as trustees for the purposes of the Securities Act 1978.

- Part 5D of the Reserve Bank Act 1989, which requires non-bank deposit takers to have a credit rating, an independent chair person and two independent directors, minimum capital, and to meet certain other requirements; and
- The Crimes Act 1961, which sets out various criminal offences.

Authorities

Financial Markets Authority

The Financial Markets Authority is the primary regulator of the New Zealand securities market, although certain roles are undertaken by the Reserve Bank of New Zealand and the Ministry of Economic Development. The Financial Market Authority's main objective is to promote and facilitate the development of fair, efficient, and transparent financial markets.

Ministry of Economic Development (Including the Companies Office)

The Registrar of Financial Service Providers registers prospectuses under the Securities Act 1978.[7] The Registrar of Companies registers documents required to be filed under the Companies Act 1993.[8] Company files at the Companies Office — of companies incorporated in New Zealand and overseas companies carrying on business in New Zealand registered under Part XVIII of the Companies Act 1993 — are open to public inspection.[9]

The Companies Office also has various powers of investigation and enforcement. The Ministry of Economic Development also is responsible for advising the government on the regulatory and legal framework for business issues.

Reserve Bank of New Zealand

The Reserve Bank of New Zealand (New Zealand's central bank) registers and supervises banks, insurance companies, and non-bank deposit takers, which includes credit unions.

NZX

The NZX is the only registered exchange in New Zealand. It comprises the three main trading markets, the NZSX, the NZDX, and the NZAX. All companies seeking to list securities on one of the three main trading markets must enter into a Listing Agreement with the NZX, agreeing to be bound by the relevant NZX Listing Rules.

7 Securities Act 1978, s 42
8 Companies Act 1993, s 362.
9 Companies Act 1993, s 363.

The NZX Listing Rules establish the NZ Markets Disciplinary Tribunal that is authorised to impose penalties for breaches of the NZX Listing Rules by listed companies and of the NZX Participant Rules by sharebrokers and other NZX participants.[10]

Commerce Commission

The Commerce Commission may grant approvals to business acquisitions or restrictive trade practices, and it investigates and takes enforcement action against anticompetitive acquisitions and trade practices, under the Commerce Act 1986.

Overseas Investment Office

The Overseas Investment Office handles applications for consent for overseas persons to invest in sensitive land or significant business assets in New Zealand under the Overseas Investment Regulations 2005.

Advertising Standards Complaints Board

The Advertising Standards Authority has a Code for Financial Advertising. The Advertising Standards Complaints Board, a self-regulatory body, hears and determines complaints about advertisements.

External Reporting Board

The External Reporting Board, an independent Crown Entity, established under the Financial Reporting Act 1993, has various functions, including implementing an overall strategy for financial reporting standards and auditing and assurance standards, issuing accounting standards, issuing auditing and assurance standards, and liaising with its international equivalents.

Industry-Specific Authorities

Self-regulatory bodies, such as the Insurance and Savings Ombudsman and the Banking Ombudsman, handle some types of disputes in their respective industries, and provide dispute resolution services under the Financial Service Providers (Regulation and Dispute Resolution) Act 2008.

Serious Fraud Office and Police

The Serious Fraud Office and the police may become involved in the event of criminal offences, such as fraud under the Crimes Act 1961.

10 The author is a member of the NZ Markets Disciplinary Tribunal.

Procedures

Financial Markets Authority

Applications. Most market participants are likely to deal with the Financial Markets Authority through following its guidance notes and under its procedures for granting:

- Exemption notices exempting a person or persons from complying with some or all of the requirements of the Securities Act 1978 and the Securities Regulations 2009, the Securities Markets Act 1988, and the Financial Reporting Act 1993;
- QFE Status under, or through, the Financial Advisers Act 2008; and
- Applications for approval as a trustee or statutory supervisor.

Investigations. In some circumstances, the Financial Markets Authority may undertake investigations. The Financial Markets Authority has a range of investigation and enforcement powers. These include:

- Receiving evidence on securities law and practice, with power to require people and entities to supply information, produce documents, and give evidence;
- Suspending or cancelling offer documents, removing a prospectus or investment statement from the market, banning advertisements, and publicising these actions;
- Entering and searching premises and vehicles;
- Investigating complaints about authorised financial advisers and taking appropriate disciplinary action;
- Enforcing securities law and the law relating to insider trading, market manipulation and disclosure by substantial security holders and financial advisers;
- Enforcing continuous disclosure law and making orders requiring disclosure by issuers;
- Requiring an exchange to provide the financial market authorities with information and assistance and making orders requiring disclosure by unregistered exchanges;
- Accepting enforceable undertakings; and
- Publishing warnings and alerts.

New Zealand Courts

The Financial Markets Authority may state a case for the opinion of the High Court on a question of law. The High Court may order the removal into the

Court of Appeal of such a case.[11] The Financial Markets Authority may lay criminal charges, or begin civil proceedings in the New Zealand courts.

With a criminal proceeding, a public announcement will only be made after the first court appearance, giving time to the defendant to seek legal advice and/or name-suppression. The Securities Act 1978 provides for various civil and criminal liabilities for breaches of the Securities Act.

NZX

The NZX, on request or of its own motion, may make rulings on the application of the Listing Rules in respect of a listed issuer. Rulings have effect as if they formed part of the Listing Rules in relation to that listed issuer.[12] Therefore, when the application of the Listing Rules is doubtful, an applicant may seek a ruling to remove that doubt (and minimise the possibility of challenge).

Alternatively, in the event of a dispute or anticipated dispute between an issuer and a security holder as to the meaning of any provisions in the Listing Rules, either may apply to the NZX to determine the issue (although the NZX is not bound to do so).[13] Furthermore, the NZX also may waive the application of any of the Listing Rules.[14]

Other Authorities

Various procedures of other authorities are referred to in the body of this chapter.

Legal Order and Regulatory Interests

Admission

NZX

The NZX Limited is a securities market. The NZX provides a market for the raising of capital by listed companies and the trading of securities. Admission of issuers to the NZX is discussed in the text, below, relating to 'Issuer Requirements'.

11 Financial Markets Authority Act 2011, s 48.
12 NZSX/NZDX Listing Rules, rule 1.10.
13 NZSX/NZDX Listing Rules, rule 1.9.1.
14 NZSX/NZDX Listing Rules, rule 1.11.1.

Futures Exchanges

The Financial Markets Authority may, on the terms and conditions (if any) that it thinks fit, declare a body corporate to be authorised to conduct one or more futures markets in New Zealand.[15]

Other Market Participants

Many other market participants also need to be licensed. Regulations exist for:

- Financial advisers — Persons who provide financial advice, discretionary management services, investment planning services, or broker services may generally need to comply with a range of registration, authorisation, qualification, disclosure, and conduct requirements, depending on the product/investments involved, the type of advice, and the class of recipients as per the Financial Advisers Act 2008 who must be registered in accordance with the provisions of that act.
- Financial service providers — Financial service providers must be registered on the Financial Service Providers Register and in some cases also join an approved dispute resolution scheme.
- Authorised public securities dealers[16] — The Securities Transfer Act 1991 provides a method of transfer for securities disposed of in an 'authorised transaction'. A disposition of securities is an 'authorised transaction' if each party is, or is acting through the agency of, a person authorised to undertake activities on a stock exchange's market, solicitor in practice on that solicitor's own account, chartered accountant, trustee corporation, registered bank, or 'authorised public securities dealer' acting in the ordinary course of business as such. An 'authorised public securities dealer' is a person or body of persons approved by the Minister of Finance as a public securities dealer.
- Futures traders — The Financial Markets Authority may authorise a person, or class of persons, to carry on the business of dealing in futures contracts. No person may carry on the business of dealing in futures contracts without an authorisation from the Financial Markets Authority or approval by an authorised futures exchange under its rules to carry on the business of dealing in futures contracts in accordance with the rules of that exchange.[17]
- Trustees and statutory supervisors — Subject to any applicable exemption, debt securities (or participatory securities) may not be offered to the public for subscription unless, among other things, the issuer has appointed a trustee (statutory supervisor), and the issuer and the trustee (statutory supervisor) have signed a trust deed (deed of participation) relating to the security. In respect of participatory securities, the issuer of the security must have appointed a person as statutory supervisor in respect of the security and both the issuer and that person need to sign a deed of participation relating to the

15 Securities Markets Act 1988, s 37(8).
16 Securities Transfer Act 1991, ss 2 and 3.
17 Securities Markets Act 1988, s 38.

security.[18] The Securities Trustees and Statutory Supervisors Act 2011 requires a person that wishes to be appointed as a trustee or statutory supervisor, in respect of a security or retirement village, to apply to the Financial Markets Authority for a license to do so. The Financial Markets Authority has released guidance on the licensing process detailing the licensing criteria. The Securities Trustees and Statutory Supervisors Act 2011 imposes certain duties and reporting obligations on trustees and statutory supervisors.

- Trustees of unit trusts — A trustee of a unit trust established in New Zealand must hold a license under the Securities Trustees and Statutory Supervisors Act 2011 for a particular unit trust.[19]
- Banks — Although no licence is needed to carry on the business of banking, no person (with some exceptions) may use any of the words 'bank', 'banker', or 'banking' in its name unless it is registered as a bank or, in the case of a person formed or registered overseas with such a word in its title, authorised by the Reserve Bank to use such a word for its representative office in New Zealand. The Reserve Bank may not register any person as a registered bank unless that person's business consists of, or to a substantial extent consists of, the borrowing and lending of money or the provision of other financial services, or both. It considers matters such as the applicant's ownership structure, size of business, ability to carry on business in a prudent manner, standing in the financial market, the suitability for their positions of the directors and senior managers, the standing of the owner of the applicant in the financial markets and, where the applicant is incorporated outside New Zealand, the law and regulatory requirements relating to the licensing of banks in that overseas country, and the nature and extent of the financial and other information disclosed to the public by the applicant.[20]

Off-Market Transactions in Securities Listed on the NZX

The NZX Regulations govern off-market transactions effected by brokers who are members of the NZX. For the purposes of the Regulations, an off-market trade is any business transacted outside FASTER (Fully Automated Screen Trading and Electronic Registration), the system used for the trading, clearing, settling, and registering securities on the NZX.[21] Off-market trades include:

- A special sale in the Retail Debt Market; and
- Transactions between members conducted outside the hours of the trading sessions on the NZX.

18 Securities Act 1978, s 33(2) and (3).
19 Unit Trusts Act 1960, s 8.
20 Reserve Bank of New Zealand Act 1989, ss 64, 65, 73, and 73A.
21 NZX Regulations, reg 1.2.

The Regulations also contain procedures for trades outside the normal trading hours of the NZX and reporting of off-market trades.

Transactions in Securities Not Listed on the NZX

New Zealand has some private markets; these are where securities are issued to associates of the relevant company and sophisticated investors. Relief from the requirement for offering documents also is provided for offers to wealthy or experienced investors, subject to certain requirements, including certificates that they meet the relevant criteria.

Securities

National Treatment and Reciprocity

Both the New Zealand Financial Markets Authority and the NZX have international reciprocal arrangements.

Financial Markets Authority

The Financial Markets Authority maintains relationships with other banking and financial regulators in New Zealand and internationally. These relationships are designed to promote effective financial sector regulation through knowledge sharing, cooperation, and benchmarking.

In particular, the Financial Markets Authority contributes to the development of the Trans-Tasman Single Economic Market agenda, and maintains a strong relationship with Australia's financial markets regulator, ASIC. The Financial Markets Authority also participates in international Memorandums of Understanding in relation to co-operation and the enforcement of financial and securities law and to facilitate cross-border investments.

Issuer Requirements

Overseas issuers (and other overseas bodies corporate operating in New Zealand) may need to register with the Companies Office. A body corporate incorporated outside New Zealand (‘overseas company’) may not carry on business in New Zealand before its name has been reserved and must apply for registration under Part XVIII of the Companies Act 1993 within 10 working days of commencing to carry on business in New Zealand.[22]

Whether or not an overseas company is ‘carrying on business’ in New Zealand and, thus, must be registered, will depend on the circumstances of each case. If it establishes or uses a share transfer office or a share registration office in New Zealand, it will be ‘carrying on business’ in New Zealand.[23] An overseas company is not subject to all the provisions of the Companies Act 1993, but only certain requirements, such as ensuring that its full name and country of

22 Companies Act 1993, ss 333(1) and 334(1).
23 Companies Act 1993, s 332(a)(i).

incorporation are stated on written communications and legal documents, filing an annual return, registering financial statements, and notifying the Companies Office of changes in its constitution, directors, place of business, and persons authorised to accept service in New Zealand.[24]

Registration under Part XVIII of the Companies Act 1993 does not have the effect of incorporating a company in New Zealand, but merely authorises it to carry on business in New Zealand. However, overseas companies can transfer their incorporation to the New Zealand register, and companies may be removed from the New Zealand register in connection with becoming incorporated under the law of another country.[25]

Listing and quotation on the NZX is granted at the discretion of the NZX, which may impose conditions (such as requiring the issuer to appoint independent directors).[26] The NZX generally does not consider applications for listing unless the anticipated market value of the issuer's securities to be quoted is at least NZ $5 million.[27] An issuer may apply to the NZX, through a Primary Market Participant acting as an Organising Participant, for listing either:

- With the NZX as its 'Home Exchange';
- With another stock exchange as its 'Home Exchange' if that issuer is domiciled or incorporated outside New Zealand and listed on a recognised stock exchange; or
- As a Dual-Listed Issuer.[28]

The 'Home Exchange' is an exchange that is recognised by the NZX and which the NZX is satisfied has primary jurisdiction in relation to listing requirements for the issuer and quotation of its securities.[29] The current fees for listing on the NZX can be found in the current Listed Issuer Fee Schedule available from the NZX website. Listed issuers who have the NZX as their Home Exchange must:

- Unless the listed issuer is a company incorporated in New Zealand, appoint a natural person resident in New Zealand with whom the NZX may communicate and who is authorised on behalf of the issuer to accept service of notices or legal proceedings from the NZX; and
- Hold all meetings of holders of quoted securities in New Zealand.[30]

If the NZX accepts a listing with an overseas exchange as the Home Exchange, the listed issuer:[31]

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24 Companies Act 1993, ss 338, 339, and 340; Financial Reporting Act 1993, ss 18 and 19.
25 Companies Act 1993, Part XIX.
26 NZSX/NZDX Listing Rules, rules 5.3.1 and 5.3.2.
27 NZSX/NZDX Listing Rules, rule 5.1.3.
28 NZSX/NZDX Listing Rules, rule 5.1.1.
29 NZSX/NZDX Listing Rules, rule 1.6.1.
30 NZSX/NZDX Listing Rules, rule 5.5.1.

- Is deemed to comply with the Listing Rules so long as it remains listed on its Home Exchange (although the NZX can declare that any of the Listing Rules apply to that issuer);
- If it applies for a class or classes of its securities quoted on its Home Exchange to be quoted on the NZX, is deemed to satisfy the Listing Rules as long as those securities remain quoted on its Home Exchange;
- Must give the NZX the same information and notices it must give to its Home Exchange at the same time it must give them to its Home Exchange; and
- Must include a statement in its annual report that the Home Exchange corporate governance rules and principles may materially differ from the NZX's and a reference to where investors may find more information about the corporate governance and principles of the Issuer's Home Exchange.[32]

As a general rule, the NZX will cancel the listing if the issuer's listing is cancelled on its Home Exchange and will suspend quotation of a class of securities if quotation is suspended on the Home Exchange.[33] The NZX operates a separate market for small to medium-sized businesses wishing to list on the NZX entitled the 'NZX Alternative Market' (NZAX). The NZAX is the marketplace for small to medium-sized, fast-growing businesses and is designed to provide a safe and efficient capital-raising facility.

Securities Requirements

In General. Companies incorporated in New Zealand must comply with the procedures in the Companies Act 1993 in issuing shares, securities convertible into shares, or options to acquire shares. Companies listed on the NZX may not issue shares (or confer entitlements to a third party's securities) unless the issue falls within one of the categories specified in the Listing Rules, such as issues authorised by ordinary resolutions of holders of each class of quoted equity securities whose rights could be affected.[34]

Securities Registers. Companies incorporated in New Zealand must keep a share register in New Zealand.[35] Subject to any exemption, an issuer of securities offered to the public must keep in New Zealand a register for each type of security it issues (eg, equity securities and unit trusts), and it may notify the Companies Office of the place it keeps its register (unless the issuer is a company incorporated in New Zealand and keeps its register at its registered office).[36]

31 NZSX/NZDX Listing Rules, rule 5.1.8.
32 NZSX/NZDX Listing Rules, rule 5.1.8.
33 NZSX/NZDX Listing Rules, rule 5.1.9.
34 NZSX/NZDX Listing Rules, rules 7.3 and 7.5.
35 Companies Act 1993, ss 87 and 88.
36 Securities Act 1978, s 51.

Quotation of Securities on the NZX. Listed issuers (or applicants for listing) may apply, through a Primary Market Participant acting as an Organising Broker, to the NZX for a class or classes of securities to be quoted on the NZX. The NZX will generally not consider an application unless the securities are held by at least 500 members of the public holding at least 25 per cent of securities in that class.[37]

However, the NZX will consider applications for a waiver from this 'spread' requirement where, in the case of debt securities or convertible equity securities, the lack of initial liquidity would not be of disadvantage to the holder or there is a commitment by one or more major holders to sell their holding into the market within a reasonable period.

Prospectus and Investment Statement Requirements. Subject to any applicable exemptions, issuers may not allot a security offered to the public for subscription:

- Unless the subscriber has received an investment statement relating to the security before subscribing;
- Unless at the time of subscription there is a current prospectus registered with the Companies Office for that security; and
- If, at the time of allotment, the issuer, or any director, knows that the investment statement or registered prospectus is false or misleading in a material particular by not referring or giving proper emphasis to adverse circumstances (whether occurring before or after registration).[38]

The fee for registration of a prospectus is NZ $320,[39] but this was to change from 1 August 2012 to NZ $2,327.11. Registered prospectuses may be amended by an instrument of amendments registered with the Registrar of Financial Service Providers.[40] The content requirements for prospectuses and investment statements are referred to in the text, below, relating to 'Requirements Applying to Offers of Listed and Unlisted Securities' and 'Exemptions from Disclosure Requirements'.

Corporate Governance. Companies incorporated in New Zealand are subject to the corporate governance requirements in Part VIII of the Companies Act 1993. The business and affairs of such a company must be managed by, or under the direction or supervision of, the board of the company. Its directors are subject to various duties, including duties to act in good faith and in the best interests of the company, to act for a proper purpose, not to trade recklessly, and to act with care and diligence. Directors' interests in a transaction must be disclosed to the board and entered in the company's 'interest register'.

37 NZSX/NZDX Listing Rules, rules 5.2.1 and 5.2.3.
38 Securities Act 1978, ss 37(1), 37A(1)(a), and 37A(1)(b).
39 Securities (Fees) Regulations 1998.
40 Securities Act 1978, s 43.

Companies listed on the NZX also are subject to the corporate governance requirements in the Listing Rules.[41] As well as requirements on the appointment, rotation, removal, remuneration, and proceedings of directors, the Listing Rules prevent directors voting on matters in which they are interested except in matters where the Companies Act 1993 requires directors to provide a certificate.[42]

Registration of Transfers of Securities. Shares of a company incorporated in New Zealand may, subject to the constitution of a company, be transferred by entering the transferee's name on the company's share register, after receiving a form of transfer signed by the transferor or under an electronic system approved under section 7 of the Securities Transfer Act 1991.[43] The Securities Transfer Act 1991 provides other means of transfer applying to a wide range of securities. Securities may be transferred:

- If fully paid up and disposed of in an 'authorised transaction', by means of a securities transfer executed in New Zealand by the transferor;[44]
- If sold in a stock exchange transaction, by a securities transfer executed in New Zealand by the transferor and a brokers transfer; and
- In accordance with an electronic system approved under section 7 of the Securities Transfer Act 1991.[45]

Forms of securities transfers and brokers transfers are set out in the Schedules to the Securities Transfer Act 1991. In May 1998, the FASTER system, which handled the electronic transfer of securities quoted on the NZX, was extended to enable scripless trading. Now, shareholders need not provide any documents when buying or selling, and listed companies send shareholders a statement after each transaction.

Periodic Disclosure

In General

This section on periodic disclosure outlines requirements for regular disclosure. It does not cover requirements for disclosure on the occurrence of particular events (such as issuing shares, declaring a dividend, appointing directors, or a change in shareholding).

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41 NZSX/NZDX Listing Rules, Appendix 16, Corporate Governance Best Practice Code.

42 NZSX/NZDX Listing Rules, rules 3.4.3 and 3.4.4.

43 Companies Act 1993, ss 84 and 85.

44 An 'authorised transaction' is a disposition of securities in which each party is, or is acting through the agency of, a person authorised to undertake trading activities on a registered stock exchange's market solicitor in practice on that solicitor's own account, chartered accountant, trustee corporation, registered bank, or authorised public securities dealer acting in the ordinary course of business (Securities Transfer Act 1991, s 2).

45 Three electronic systems have been approved for the New Zealand and Australian stock exchanges.

General Disclosure Requirements

In General. Companies incorporated in New Zealand must each year produce an annual report and an annual return.

Annual Report. The boards of most companies, within five months after the company's balance date, must prepare an annual report on the affairs of the company during the accounting period ending on that date. The annual report must be sent to shareholders not less than 20 working days before the date of the annual meeting. The annual report contains information pertaining to matters such as:

- Changes in the nature of the company's business;
- Financial statements;
- Auditor's report;
- Particulars of entries in the company's interests register;
- Value of the remuneration and other benefits received by each director or former director during the accounting period;
- Number of employees or former employees who received remuneration and other benefits worth more than NZ $100,000 per annum (disclosed in NZ $10,000 brackets);
- Donations by the company; and
- Directors and auditor's fees.[46]

Annual Return. The board of a company must file an annual return with the Companies Office each year at the time determined by the Companies Office.[47] The annual return discloses matters such as the company's registered office, address for service, types and number of shares, directors, shareholders, and the date of the annual meeting. Overseas companies carrying on business in New Zealand (but not incorporated in New Zealand) must file an annual return, but they need not produce an annual report.[48]

Access to Information. A company incorporated in New Zealand must keep its certificate of incorporation, constitution, share register, names and residential addresses of directors and registered office, and address for service available for public inspection. Shareholders also may inspect minutes of all meetings and resolutions of shareholders, copies of written communications to shareholders, directors' certificates, and the interests register.[49] Issuers must make their registers of equity securities, debt securities, participatory securities, and units in unit trusts open to public inspection.[50]

46 Companies Act 1993, ss 208, 209, and 211.
47 Companies Act 1993, s 214.
48 Companies Act 1993, s 340.
49 Companies Act 1993, ss 215 and 216.
50 Securities Act 1978, s 52.

A shareholder may make a written request to a company for information held by the company. A company may refuse to provide information if disclosure would, or would be likely to, prejudice the commercial position of the company or any other person, or the request is frivolous or vexatious. It also may impose a reasonable charge for providing the information. A shareholder can seek a court order to compel the company to provide the information. The court also has the power, on the application of a shareholder or creditor of a company, to make an order authorising a person to inspect and make copies of company records.[51]

Financial Disclosure Requirements

Preparing Financial Statements. The directors of issuers and most companies must ensure that financial statements are completed and signed on behalf of the directors within the prescribed time (usually five months after the balance date).[52] The financial statements must comply with generally accepted accounting practice and give a true and fair view.[53]

However, the financial statements are taken to comply with section 11 of the Financial Reporting Act 1993 if the Companies Office notifies an issuer or company incorporated outside New Zealand that it is satisfied that its financial statements comply with the requirements in force in the country in which it is incorporated and those requirements are substantially the same as those under the Financial Reporting Act 1993.

Exemptions allow for the use of financial statements complying with the laws of foreign jurisdictions in certain cases. If an issuer or company has subsidiaries, it also must prepare group financial statements.[54] There is similar relief to that described above, for group financial statements that comply with foreign requirements. Issuers' financial statements and group financial statements must be audited.[55]

An auditor of a company incorporated in New Zealand must make a report to the shareholders on the financial statements audited by him.[56] An auditor of an issuer of debt securities or participatory securities offered to the public, or of an issuer of units in a unit trust, must copy his reports to the trustee, statutory supervisor, or unit trustee.[57]

Registering Financial Statements. The following must file at the Companies Office copies of financial statements, any group financial statements, and the

51 Companies Act 1993, ss 178 and 179.
52 Financial Reporting Act 1993, s 10(1).
53 Financial Reporting Act 1993, s 11(1) and (2).
54 Financial Reporting Act 1993, s 13.
55 Financial Reporting Act 1993, s 15.
56 Companies Act 1993, s 205(1).
57 Securities Act 1978, ss 50(1) and 50A(1).

auditor's report within 20 working days of when the statements must be signed (i.e., within 20 working days and five months of the company's balance date):

- Issuers;
- Companies incorporated outside New Zealand that carry on business in New Zealand;
- Subsidiaries of companies incorporated outside New Zealand; and
- Companies in which at least 25 per cent of the voting power is held by a company incorporated outside New Zealand, a direct or indirect subsidiary of a company incorporated outside New Zealand, or a person not ordinarily resident in New Zealand.[58]

Disclosure to Security Holders under the Securities Act 1978

Issuers of securities offered to the public must send to each security holder:

- Documents, information, and matters required to be sent by regulations;[59] and
- At the request of a security holder, a copy of its most recent annual report, its most recent financial statements required to be registered, any trust deed or deed of participation, any guarantee of payment of money owing in respect of the security, any guarantor's financial statements, the most recent prospectus, the most recent investment statement, and a comparison of the actual returns or results against any prospective financial information contained in any prospectus, disclosure statement, investment statement, or advertisement.[60]

Additional Disclosure Requirements for Listed Issuers

General Duty to Release Information Affecting Prices. Once an issuer listed on the NZX becomes aware of any 'Material Information'[61] concerning it, the issuer must disclose that Material Information to the Exchange unless:

- A reasonable person would not expect the information to be disclosed;
- The information is confidential and its confidentiality is maintained; and
- One or more of the following applies: the release of information would be a breach of law; the information concerns an incomplete proposal or negotiation; the information comprises matters of supposition or is insufficiently definite to warrant disclosure; the information is generated for

58 Financial Reporting Act 1993, ss 18 and 19.

59 At the time of writing, there are no such regulations.

60 Securities Act 1978, ss 54A and 54B; Securities Regulations 2009, Part 6, reg 44.

61 'Material Information' in relation to an issuer is information that: (a) a reasonable person would expect, if it were 'generally available to the market', to have a material effect on the price or value of quoted securities of the issuer; and (b) relates to particular securities, a particular issuer, or particular issuers, rather than to securities generally or issuers generally. (NZSX/ NZDX Listing Rules, rule 1.6.1).

the internal management purposes of the issuer; or the information is a trade secret.[62]

Listed issuers may not disclose any material information to the public, other stock exchanges (except where the issuer is listed on another stock exchange and it releases information to the NZX before or at the same time as it releases information to the other exchange(s) on which it is listed), or certain other parties prior to disclosing that material information to the Exchange, and prior to an acknowledgement from the Exchange of receipt of that material information.[63]

Listed issuers must release material information to the Exchange to the extent necessary to prevent development or subsistence of a market for its quoted securities which is materially influenced by false or misleading information emanating from the issuer, an associated person, or any credible source.[64] Listed issuers also must disclose to the NZX information on arrangements for which members of the public might reasonably consider the directors have a conflict of interest which may lead them to approve terms materially more favourable to the other party than arm's length terms.[65]

Annual Reports and Half Yearly Reports. Listed issuers must issue an annual report, to be issued to the NZX and to holders of quoted securities within three months after the end of the issuer's financial year,[66] and a half-yearly report, to be issued to the NZX and to holders of quoted securities within three months after the end of the first six months of each financial year.[67] As well as disclosing all information required by law (such as by section 211 of the Companies Act 1993 and part 2 of the Securities Markets Act 1988), the annual report must disclose:

- The information required to be published by sub-part 3 of part 2 of the Securities Markets Act 1988 and, in the case of a company, the information required by section 211 of the Companies Act 1993;
- The names and holdings of the equity security holders with the 20 largest holdings of quoted equity securities;
- The equity securities in which each director has a relevant interest;
- The details of the spread of security holders;
- The issuer's current credit rating status (if any);
- The waivers granted by the NZX and published, applicable as at the balance date;
- The details of any disciplinary action taken by the NZX;

62 NZSX/NZDX Listing Rules, rule 10.1.1(a).
63 NZSX/NZDX Listing Rules, rule 10.1.1(b).
64 NZSX/NZDX Listing Rules, rule 10.1.1(c).
65 NZSX/NZDX Listing Rules, rule 10.1.2.
66 NZSX/NZDX Listing Rules, rule 10.5.1.
67 NZSX/NZDX Listing Rules, rule 10.5.3.

- A statement of any corporate governance polices, practices, and processes;
- A statement as to which of the directors are independent and which are not; and
- The details of any directors appointed by security holders.

The NZX may require listed issuers to provide, in their financial statements or otherwise, information additional to that required by the Financial Reporting Act 1993.[68]

Preliminary Announcements. Listed issuers must make preliminary announcements through the NZX as soon as the relevant information is available (and in any event before the release of the annual or half-yearly report and not later than 60 days after the end of the financial reporting period). 'Preliminary announcements' contain information prescribed by the NZSX/ NZDX Listing Rules.[69]

Obligation to Copy Notices to Exchange. Listed issuers must give the NZX a copy of every notice or communication given to holders of that issuer's quoted securities and any stock exchange other than the NZX.[70]

Substantial Security Holders. A person who begins to have a substantial holding in a public issuer must disclose that fact as soon as the person knows, or ought to know, that the person has the substantial holding. There are other situations in which disclosure also is required if there is a movement of one per cent or more in a substantial holding, there has been any change in the nature of any relevant interest in the substantial holding, and the person ceases to have a substantial holding.[71]

Directors and Officers Disclosure

Directors and officers of private issuers (broadly, NZX listed issuers) must disclose any trade by them of a relevant interest in a security issued by their public issuer or a related body corporate within five trading days and of their holding of such securities within five trading days of the public issuer's listing or their appointment.[72]

Trading Rules

Securities Offerings

Offer. The Securities Act 1978 regulates offers of securities to the public, including initial public offers by an issuer of securities to the public in New Zealand for the first time and new issues by existing issuers and certain offers of

68 NZSX/NZDX Listing Rules, rules 10.5.5 and 10.6.
69 NZSX/NZDX Listing Rules, rules 10.4.1 and 10.4.2.
70 NZSX/NZDX Listing Rules, rule 10.8.2.
71 Securities Markets Act 1988, ss 22, 23, 24, and 25.
72 Securities Markets Act 1988, s 19T.

previously allotted equity securities which are offered to the public with the advice, encouragement, or knowing assistance of the original issuer, or when the original allotment was made with a view to offering the securities to the public and they have not yet been so offered.

The Securities Act 1978 applies to securities of bodies corporate incorporated outside New Zealand, as well as those incorporated in New Zealand. It is not possible to contract out of the Securities Act 1978.[73] A 'security' is generally any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person. It includes:

- An equity security;
- A debt security;
- A unit in a unit trust;
- An interest in a superannuation scheme;
- A life insurance policy; and
- A renewal or variation of the terms or conditions of any such interest or right.[74]

An 'offer' of securities includes an invitation and any proposal or invitation to make an offer. References in the Securities Act 1978 to an offer of securities to the public include distributing an advertisement, a prospectus, or an application form for the subscription of securities.[75] The following are not offers of securities to the public:

- An offer of securities made to any or all of the following persons only (a) relatives or close business associates of the issuer or of a director of the issuer; (b) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money; (c) persons who are each required to pay a minimum subscription price of at least NZ $500,000 for the securities before the allotment of those securities; (d) persons who have each previously paid a minimum subscription price of at least NZ $500,000 for securities (the initial securities) in a single transaction before the allotment of the initial securities, provided that the offer of the securities is made by the issuer of the initial securities; and the offer of the securities is made within 18 months of the date of the first allotment of the initial securities; and (e) any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public; and

73 Securities Act 1978, s 4.
74 Securities Act 1978, s 2D.
75 Securities Act 1978, ss 2(1) and 3(4).

- An invitation to a person to enter into a *bona fide* underwriting or sub-underwriting agreement with respect to an offer of securities.[76]

Some types of offers are excluded from most or all of the disclosure requirements in the Securities Act 1978,[77] including offers of previously allotted securities unless the securities were originally allotted with a view to being offered for sale to the public in New Zealand and have not previously been offered for sale to the public in New Zealand; are units in a unit trust that have previously been allotted (whether in New Zealand or elsewhere) and are being offered, sold, or otherwise disposed of to the public for subscription by the manager or unit trustee of the unit trust or by an associated person of that manager or unit trustee; or are equity securities (or securities convertible into equity securities) and the holder or offeror, not being the original allotter, offers the securities for sale to the public in New Zealand and the original allotter advises, encourages, or knowingly assists the holder or offeror.

Offers to the public of previously allotted securities not subject to the usual disclosure requirements will have implied a term that, except to the extent disclosed for the purposes of the offer, the offeror has no information in relation to the original allotter that is not publicly available and that would, or would be likely to, affect the price of the security.

Public. Offers of securities 'to the public' include offers of securities, whether or not any such offer is calculated to result in the securities becoming available for subscription by persons other than those receiving the offer, to any section of the public, however selected; individual members of the public selected at random; and a person who became known to the offeror as a result of any advertisement made by or on behalf of the offeror that was intended or likely to result in the public seeking further information or advice about any investment opportunity or services. However, none of the following are offers to the public:

- Offers made to any or all of the following persons only: (a) relatives or close business associates of the issuer, (b) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money, (c) persons who are each required to pay a minimum subscription price of at least NZ $500,000 for securities before the allotment of those securities, (d) persons who have each previously paid a minimum subscription price of at least NZ $500,000 for securities (the initial securities) in a single transaction before the allotment of the initial securities provided that the offer of the securities is made by the issuer of the initial securities; and the offer of the securities is made within 18 months of the date of the first allotment of the initial securities, and (e) any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public; and

76 Securities Act 1978, s 3(2).
77 Securities Act 1978, ss 5, 6, and 6A.

- An invitation to a person to enter into a *bona fide* underwriting or sub-underwriting agreement.[78]

Whether or not persons to whom an offer of securities is made constitute 'the public' is a question of fact, depending on the circumstances. The protective purpose of the Securities Act 1978 is of importance in interpreting section 3.[79] Persons are not precluded from being members of the public merely because they are purchasers from, or employees or clients of, or holders of securities previously issued by, the issuer.[80]

Therefore, an offer of securities to some or all of the existing shareholders and/or debenture holders of a company may be an offer to the public.[81] It is often difficult to establish with sufficient certainty that an offer is not made 'to the public' when it is made to several people. Therefore, overseas issuers operating in the New Zealand market often rely on exemption notices rather than on there being no 'offer to the public'.

Place of Offer. Most disclosure requirements in the Securities Act 1978 apply to securities offered to the public in New Zealand, regardless of where any resulting allotment occurs and where the issuer is resident, incorporated, or carries on business.[82]

Certain Securities Act provisions relating to prohibitions on advertisements apply to advertisements that contain or refer to an offer of securities to the public outside New Zealand and that are distributed or to be distributed to a person outside New Zealand by persons resident or having a place of business in New Zealand. Provisions relating to criminal liability for misstatements in offering documents apply to such advertisements where they are distributed by persons resident or having a principal place of business in New Zealand.[83]

Requirements Applying to Offers of Listed and Unlisted Securities. To comply with the Securities Act 1978, most offers of securities to the public by or on behalf of an issuer are made primarily in (or accompanied by) an investment statement.

A prospectus, which is intended to contain greater detail on the offer and the issuer, is available on request. This two-tier disclosure regime has been mandatory since 1 April 1998. Before then, the registered prospectus was the primary disclosure document. The Financial Markets Conduct Bill is set to replace these requirements with a different disclosure regime, expected to be effective in 2013.

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78 Securities Act 1978, s 3(1) and (2).
79 *Securities Commission v Kiwi Co-operative Dairies Ltd* [1995] 3 NZLR 26, at p 31.
80 Securities Act 1978, s 3(3).
81 *Robt Jones Investments Ltd v Gardner* (1988) 4 NZCLC 64,412, at p 64,420; *Securities Commission v Kiwi Co-operative Dairies Ltd* [1995] 3 NZLR 26, at p 30.
82 Securities Act 1978, s 7(1).
83 Securities Act 1978, s 7(3).

Investment Statements. The purpose of an investment statement is to provide certain key information that is likely to assist a prudent but non-expert person to decide whether or not to subscribe for securities and bring to the attention of such a person the fact that other important information about the securities is available to that person in other documents.[84] The contents of investment statements are prescribed by the Securities Act 1978 and the Securities Regulations 2009, and they relate to the following questions:

- What sort of investment is this?
- Who is involved in providing it for me?
- How much do I pay?
- What are the charges?
- What returns will I get?
- What are my risks?
- Can the investment be altered?
- How do I cash in my investment?
- Who do I contact with inquiries about my investment?
- Is there anyone to whom I can complain if I have problems with the investment?
- What other information can I obtain about this investment?

There are prescribed matters that must be addressed under each question. Issuers may not allot a security offered to the public if the subscriber did not receive an investment statement before subscribing.[85] Investment statements are not registered with any government agency.

Prospectuses. Prospectuses need be given to prospective subscribers only on request. The contents of prospectuses are prescribed by the Securities Act 1978 and the Securities Regulations 2009. The exact requirements depend on whether the security is an equity security, debt security, participatory security, unit in a unit trust, life insurance policy, or an interest in a KiwiSaver Scheme or superannuation scheme.

Prospectuses are registered with the Registrar of Financial Service Providers. They are generally valid for nine months after the date of the financial statements they contain. In some circumstances, this period can be extended for a further nine months by the directors providing a certificate that, among other things, states that the financial position of the company has not materially and adversely changed and that the prospectus is not false or misleading.[86]

Other Requirements in the Securities Act 1978. The Securities Act 1978 and the Securities Regulations 2009 also regulate the contents of advertisements that

84 Securities Act 1978, s 38D.
85 Securities Act 1978, s 37A.
86 Securities Act 1978, s 37A.

contain or refer to an offer of securities to the public or are reasonably likely to induce persons to subscribe for such securities and require issuers to keep registers of securities. Securities may not be offered to the public unless:

- For debt securities, the issuer has appointed a trustee, and has established and registered with the Registrar of Financial Service Providers a trust deed; and
- For participatory securities, the issuer has appointed a 'statutory supervisor' and has established and registered with the Registrar of Financial Service Providers a 'deed of participation'.[87]

Requirements Applying Only to Offers of Listed Securities. The NZSX/NZDX Listing Rules contain requirements for offering documents of issuers listed on the NZSX or the NZDX in addition to the requirements in the Securities Act 1978. Listed issuers must prepare and issue an offering document (which will usually be an investment statement) when required under the Securities Act 1978 or seeking an initial quotation of a security.[88]

The Listing Rules contain extra content requirements for such offering documents (and for trust deeds, in the case of debt securities), and they require listed issuers to obtain the NZX's approval of offering documents and prospectuses.[89]

Exemptions from Disclosure Requirements. The Financial Markets Authority may exempt any person or class of persons from the disclosure requirements in the Securities Act 1978 and the Securities Regulations 2009.[90] 'Exemption notices' are published in the *New Zealand Gazette*, an official government publication, and as statutory regulations. Exemption notices can be general, applying to all issuers of a specified type, or specific, relating to a particular issuer and/or transaction.

The Financial Markets Authority may not grant an exemption unless it is satisfied that the exemption would not cause significant detriment to subscribers for the securities to which the exemption relates who are members of the public in New Zealand, and the extent of the exemption is not broader than is reasonably necessary to address the matters that gave rise to the exemption. Several exemption notices are in force that may assist in international transactions.

Securities Act (Overseas Companies) Exemption Notice 2002. The Securities Act (Overseas Companies) Exemption Notice 2002 exempts companies incorporated outside New Zealand from the prospectus, investment statement, trustee, and statutory supervisor requirements where securities are (or will be) quoted on a stock exchange in the United Kingdom, Australia, Canada, the United States, Spain, or Hong Kong, and the offer to members of the public in New Zealand is either made to existing security holders, or holders of quoted securities of a

87 Securities Act 1978, s 33(2) and (3).
88 NZSX/NZDX Listing Rules, rule 7.1.1.
89 NZSX/NZDX Listing Rules, rules 3.2, 6.1, 7.1, and 7.8.
90 Securities Act 1978, s 70B.

promoter which is an associated company and is incorporated outside New Zealand, or an offer of securities as consideration for the acquisition or cancellation of quoted securities of another company incorporated outside New Zealand.

Securities Act (Overseas Listed Issuers) Exemption Notice 2002. The Securities Act (Overseas Listed Issuers) Exemption Notice 2002 exempts companies incorporated in the United Kingdom or the United States from the prospectus, trustee, and statutory supervisor requirements where securities are (or will be) quoted on the London Stock Exchange, NASDAQ, or the New York Stock Exchange if:

- There is an overseas prospectus;
- The Companies Office has received the overseas prospectus and various other documents;
- The issuer provides the overseas prospectus to offerees on request;
- The investment statement includes various warnings; and
- Offers are made in the relevant overseas jurisdiction at the same time.

Securities Act (Australian Issuers) Exemption Notice 2002. The Securities Act (Australian Issuers) Exemption Notice 2002 exempts companies incorporated in Australia and companies incorporated outside Australia that are (or will be) listed on the Australian Securities Exchange from the prospectus requirements for equity securities and debt securities, if:

- There is an Australian prospectus;
- The Companies Office has received the Australian prospectus and various other documents;
- The issuer provides the Australian prospectus to offerees on request;
- The investment statement includes various warnings; and
- Offers are made in Australia at the same time.

For debt securities, an exemption from the trustee requirement also is available if a person authorised under the laws of Australia to act as trustee has been appointed as trustee.

Securities Act (Overseas Takeovers by New Zealand Companies) Exemption Notice 2002. The Securities Act (Overseas Takeovers by New Zealand Companies) Exemption Notice 2002 exempts companies incorporated in New Zealand from the prospectus and investment statement requirements for equity securities quoted on the NZX if the securities are offered as consideration for the acquisition of securities issued by an overseas company quoted on a stock exchange in the United Kingdom, Australia, Canada, the United States, or Hong Kong.

Securities Act (Overseas Employee Share Purchase Schemes) Exemption Notice 2002. The Securities Act (Overseas Employee Share Purchase Schemes) Exemption Notice 2002 exempts issuers incorporated in Australia, Austria, Canada, Denmark, Finland, France, Germany, Ireland, The Netherlands, Norway, Singapore, South Africa, Sweden, Switzerland, the United Kingdom, and the United States that are listed on a securities exchange in one of these jurisdictions, and other named issuers, from the prospectus, investment statement, and certain other requirements, for offers of securities made under an employee share purchase scheme. Conditions include:

- The securities are allotted only to employees or directors of the issuer or its subsidiaries;
- Either an English version or translation of its most recent annual report and published financial statements, the rules of the employee share purchase scheme (or a summary), and the terms of the offer in New Zealand are sent to offerees, or a notice stating that this information is available on an internet or intranet site operated by or on behalf of the issuer and certain other information is sent to offerees;
- The above documents are received by the Registrar of Companies before allotment; and
- The securities are also offered, or have previously been offered, under the employee share purchase scheme in the jurisdiction in which the scheme is established.

The Securities Act (Overseas Employee Share Purchase Schemes) Exemption Notice 2002 also exempts New Zealand registered banks and overseas banks, the issuer or certain subsidiaries, or persons acting on their behalf from the prospectus, investment statement, and trustee and statutory supervisor requirements, in respect of debt or participatory securities offered in connection with participation in an exempt overseas issuer's employee share purchase scheme. Conditions of the various exemptions are that:

- The securities are allotted only to employees or directors of the exempt overseas issuer or its subsidiaries;
- Either an English version or translation of its most recent annual report and published financial statements, the rules of the employee share purchase scheme (or a summary), and the terms of the offer in New Zealand are sent to offerees, or a notice stating that this information is available on an internet or intranet site operated by or on behalf of the issuer, and certain other information, is sent to offerees;
- The above documents are received by the Registrar of Companies before allotment; and
- The subscriptions received are held in a bank account that holds only those subscriptions until allotment.

Although some of the Exemption Notices do not exempt issuers from the requirement to issue an investment statement, the Financial Markets Authority may be willing to consider applications for class exemptions from this requirement where overseas issuers are obliged by the law of another jurisdiction, possibly also by the terms of an established self-regulatory procedure, to distribute a document that is, in substance, very similar to the investment statement.

Securities (Mutual Recognition of Securities Offerings – Australia) Regulations 2008. The Securities (Mutual Recognition of Securities Offerings – Australia) Regulations 2008 relieves Australian issuers from most of the requirements of the Securities Act 1978 and Securities Regulations 2009 if their offer is regulated in Australia, they provide their Australian offer document with a prescribed warning statement to New Zealand offerees, they file certain documents with the Registrar of Financial Services Providers, and they comply with certain other requirements. NZX. The NZX may, in any particular case, waive the application of the Listing Rules.[91]

Disclosure of Acquisition of Substantial Holdings

In General. Part II of the Securities Markets Act 1988 requires disclosure by 'substantial security holders', ie, persons with a 'relevant interest' in five per cent or more of the voting securities of a person listed on the NZX. 'Relevant interest' is defined very widely in section 5 of the Securities Markets Act 1988 to broadly encompass three categories of relevant interest, namely:

- Beneficial ownership;
- Presently existing powers; and
- Arrangements that may give rise to powers in the future.[92]

As well as beneficial interests, it covers powers to exercise, or control the exercise of, any right to vote attached to the voting security or acquire or dispose, or to control the acquisition or disposition, of the voting security. A person also will have a relevant interest if:

- The person may, at any time, have the power to do any of the above under any trust, agreement, arrangement, or understanding relating to a security (whether or not that person is a party to it);
- The person has any of the above powers over 20 per cent or more of the voting securities of another person with a relevant interest (ie, the definition 'looks through' persons with a relevant interest to cover, for example, major shareholders of such persons); or
- A body corporate related to it (such as a holding company or subsidiary) has a relevant interest.

91 NZSX/NZDX Listing Rules, rule 1.11.
92 *Mercury Energy Ltd v Utilicorp NZ Ltd* [1997] 1 NZLR 492, at p 501.

The powers set out above may be expressed or implied, direct or indirect, legally enforceable or not, exercisable presently or in the future, or exercisable alone or jointly with another person or persons.

Section 5 of the Securities Markets Act 1988 covers securities which could be acquired in the future under an existing right of first refusal or put option.[93] The purpose of the substantial security holder disclosure requirements is:

> '. . . to promote the prompt provision of adequate information to the market which in turn will enable the entire market to make informed judgments based on quality information. One would expect the market to want to know anything that could materially affect a decision whether and when to buy or sell, at what price and on what terms. Of central importance in that regard will be information as to the identity of those who have the destiny of the company in their hands.'[94]

Shareholder Duties. Notice must be given to the listed issuer and to the NZX by:

- Every person who becomes a substantial security holder in a listed issuer;
- A substantial security holder on a change in the total number of voting securities of a listed issuer in which it has a relevant interest where the difference between the number of such securities immediately after the change and the number of securities required to be stated in the last notice is equal to one per cent or more of the total number of the listed issuer's issued voting securities;
- A substantial security holder on any change in the nature of any relevant interest it holds in the voting securities of a listed issuer; and
- A person ceasing to be a substantial security holder in a listed issuer.

Notices must be in the form prescribed by the Securities (Substantial Security Holders) Regulations 2007, and they must be given as soon as the person knows, or ought to know, of the relevant circumstances.[95] However, a person need not give a notice if the requirement to comply arises by reason only of the fact that that person is related to another person who must comply, and that other person complies.[96]

Company Duties. A listed issuer must keep a register for the disclosures given to it. The register must be kept in New Zealand at the registered office of the

93 *Mercury Energy Ltd v Utilicorp NZ Ltd* [1997] 1 NZLR 492.
94 *Mercury Energy Ltd v Utilicorp NZ Ltd* [1997] 1 NZLR 492, at p 503, citations omitted from quote.
95 Securities Markets Act 1988, ss 20, 21, and 22.
96 Securities Markets Act 1988, s 30.

public issuer or any other place in New Zealand, of which notice is given in accordance with the statutory requirements.[97]

Investigating Persons Holding Relevant Interests. Listed issuers may require a person registered as the holder of some of its voting securities to disclose to it the name and address of every person who holds a relevant interest in those voting securities and the nature of that interest and, if the registered holder is unable to supply any such information, such other particulars as will, or are likely to, assist in identifying that person and the nature of that interest.[98]

Listed issuers also may require any person who the listed issuer believes has, or may have, a relevant interest in its voting securities to supply such information as it may specify, to assist it to ascertain who is, or may be, a substantial security holder.[99] The NZX may require a listed issuer to exercise powers under sub-part 3 of part 2 of the Securities Markets Act 1988 and provide to the NZX for public release any information obtained under those powers (as a result of a request by the NZX or otherwise).[100]

Exemptions. The Financial Markets Authority may, on the terms and conditions (if any) that it thinks fit, exempt any transaction, person, class of persons, class of relevant interests, acquisitions, or disposals from compliance with any directors' and officers' disclosure obligation or obligations and exempt any person or class of persons, any transaction or class of transactions, or any class of relevant interests, substantial holdings, or relevant events from compliance with any substantial holding disclosure obligation or obligations.[101] The NZX has a general power to grant waivers from the NZX Listing Rules.[102]

Director and Officer Disclosure. Directors and officers of public issuers (broadly, NZX listed issuers) must disclose any trade by them of a relevant interest in a security issued by their public issuer or a related body corporate within five trading days and of their holdings of such securities within five trading days of the public issuer's listing of their appointment.[103]

Insider Trading

Insider Trading Liabilities. The Securities Markets Act 1988 contains an insider trading regime, with provisions prohibiting market manipulation, and new enforcement powers and penalties for breaches of securities trading rules, including the creation of indictable criminal offences for insider trading and market manipulation.

97 Securities Markets Act 1988, s 35C.
98 Securities Markets Act 1988, s 35.
99 Securities Markets Act 1988, s 35A.
100 NZSX/NZDX Listing Rules, rule 10.9.
101 Securities Markets Act 1988, s 48.
102 NZSX/NZDX Listing Rules, rule 1.11.
103 Securities Markets Act 1988, s 19T.

A person is an information insider of a public issuer if that person has material information relating to the public issuer that is not generally available to the market, and knows or ought reasonably to know that that information is material information and knows or ought reasonably to know that the information is not generally available to the market.[104] Therefore, a person can be an information insider even if that information is not derived from the issuer itself. If a person is an information insider of a public issuer, he may not:

- Trade securities of the public issuer;
- Directly or indirectly disclose inside information to another person if he reasonably ought to know or believes that that other person will, or is likely to, trade securities of the public issuer, continue to hold securities of the public issuer, or convince others to do the same; and
- Advise or encourage another person to trade or hold securities of the public issuer, or to advise another person to advise a third person to do the same. Insider conduct incurs criminal liability. A person who contravenes any of the above commits an offence if the person has actual knowledge that the information is material information; and that the information is not generally available to the market. The offence carries a maximum penalty of five years' imprisonment and a NZ $300,000 fine for an individual or a NZ $1,000,000 fine for a body corporate.

Market manipulation is prohibited. A person may not make a statement of disseminate information if:

- A material aspect of the statement or information is false or the statement or information is materially misleading;
- The person knows or reasonably ought to know that a material aspect of the statement or information is false or that the statement or information is materially misleading; and
- The statement or information is likely to induce a person to trade in the securities of a public issuer; or have the effect of increasing, reducing, maintaining, or stabilising the price for trading in those securities; or induce a person to vote for, or vote against, a transaction, or to abstain from voting in respect of that transaction.[105]

Persons against whom a judgment has been obtained under the insider trading provisions in the Securities Markets Act 1988 (or who have been convicted of a crime of dishonesty) cannot for five years after that time be a director or promoter or be involved in the management of a company without the leave of the New Zealand High Court. This includes both companies incorporated in New Zealand and overseas companies carrying on business in New Zealand.[106]

104 Securities Markets Act 1988, s 8A.
105 Securities Markets Act 1988, s 11.
106 Companies Act 1993, s 382.

Note that, as set out above, offers to the public in New Zealand of previously allotted securities not subject to the usual disclosure requirements will have an implied term that, except to the extent disclosed for the purposes of the offer, the offeror has no information in relation to the original allotter that is not publicly available and that would, or would be likely to, affect the price of the security.

Public Takeover Bids

Territorial Application. The Takeovers Act 1993, the Takeovers Code Approval Order 2000, and the Commerce Act 1986 are relevant to takeover bids. The Takeovers Act and Takeovers Code regulate bids for shares or the control of shares in code companies (companies incorporated in New Zealand which are parties to a listing agreement with a registered exchange and that have securities that confer voting rights quoted on the registered exchange's securities market, or which were parties to such an agreement in the last 12 months, or which have at least 50 shareholders). The Code applies to bidders bidding for New Zealand companies, irrespective of whether the bidder is a New Zealander or a foreigner.

The Commerce Act 1986 applies to conduct outside New Zealand by any person resident or carrying on business in New Zealand to the extent that such conduct affects a market in New Zealand. In addition, section 47 (prohibiting acquisitions that have the effect of substantially lessening competition in a market) extends to the acquisition outside New Zealand by a person (whether or not that person is resident or carries on business in New Zealand) of shares or assets to the extent that the acquisition affects a market in New Zealand.[107]

Procedural Requirements. The Takeovers Code applies to companies incorporated in New Zealand which are, or in the previous 12 months have been, listed with a registered exchange and have securities that confer voting rights quoted on the registered exchange's securities market and which have more than 50 shareholders. Neither the Act nor the Code currently applies to other listed entities, such as unit trusts and group investment funds.

Fundamental Rule

In General. The core of the Code is the 'fundamental rule', which prohibits a person becoming the holder or controller of voting rights in a Code company if he and his 'associates' would afterwards control more than 20 per cent of the voting rights, unless the increase fits within one of the exceptions to the fundamental rule or the Panel grants an exemption. If a person already holds more than 20 per cent, he cannot become the holder of an increased level of voting rights except in compliance with the Code or through an exception or exemption.[108]

The term 'associate' is very widely defined. For example, a person is an associate of another if he 'has a business relationship, personal relationship, or

107 Commerce Act 1986, s 4(1) and (3).
108 Takeovers Act 1993, s 45.

an ownership relationship such that they should, under the circumstances, be regarded as associates'. It also includes related companies, people who act jointly or in concert, those who act on others' instructions, and third parties who should be regarded as associates because of connections through a common associate.

Exceptions to the Fundamental Rule. The permitted methods of increasing the holding or control beyond the 20 per cent threshold are:

- Full offer — A full offer can be made for all voting securities of the target company as well as any non-voting equity securities on issue. If the target company has different classes of securities, the full offer must be fair and reasonable between different classes.
- Partial offer — A partial offer (for less than 100 per cent) is permitted but must be extended to all holders of voting securities (non-voting securities can be excluded) and must be for a specific percentage of the target company's voting securities. Again, if there is more than one class of voting securities, the partial offer must extend to each class. If the offeror's existing holding (together with associates) is 50 per cent or less, the offer must be for securities which will result in the offeror holding or controlling more than 50 per cent of the voting rights. However, a partial offer can be made for a lesser percentage if a written approval procedure is followed and is successful. If excess acceptances of an offer are received, the acceptances must be scaled back proportionately.
- Shareholder approval — A specific purchase or issue of equity securities may be approved by shareholders in the target company by an ordinary resolution (simple majority of shareholders voting on the issue), but the persons acquiring and disposing of the securities may not vote on the proposal.
- Limited five per cent creep — A person holding or controlling more than 50 per cent, but less than 90 per cent, of the voting rights, can increase their holding by up to five per cent of the total voting rights in any 12-month period. Unlike some other countries' codes, the 'creep' provision does not apply to holders with less than 50 per cent; there is a 'no-fly zone' between 20 per cent and 50 per cent.
- Compulsory acquisition — Acquisitions by persons holding or controlling 90 per cent or more of the voting rights can increase that holding without restriction. In addition, above the 90 per cent threshold, the holder may compulsorily acquire the remaining securities and may be required to acquire the securities of remaining holders.

Exemptions — Involuntary Increases. Under the Act, the Panel has a power to grant exemptions from the Code. Exemptions have been granted where the holder or its associates increase their percentage holding through share buy-backs, *pro rata* or not *pro rata* issues, or enforcement of lender security rights, while voting as proxy holders or representatives through transfers by operation of law, such as beneficiaries of wills, intra-group transfers, or as nominees, sharebrokers, underwriters, executors, or trustees. Conditions attach to these exemptions.

Offer Rules and Other Code Requirements. The Code contains detailed requirements for partial offers and full offers, and other requirements, which include:

- Disclosure documents — Detailed provisions in the Schedules to the Code specify the contents of the offeror's takeover notice and the target company's statement in response.
- Same terms and conditions — An offer must be on the same terms and conditions, including the same consideration, to all holders of securities of the same class.
- Independent adviser reports — The Code requires directors of the target company to obtain a report on the merits of an offer from an independent adviser. Independent adviser reports also are required to address fairness between classes, where an offer is made for more than one class of security, and to accompany a notice of meeting for any shareholder approval of an increase under the Code.
- Offer period — The offer must be open between 30 and 90 days, although a full offer can be extended up to 60 days beginning on the day on which the offer becomes unconditional as to a minimum level of acceptances.
- Minimum acceptance condition — Where the offeror holds or controls less than 50 per cent of the voting securities, the offer must be conditional on receiving acceptances which will bring the offeror's total holding above the 50 per cent threshold, unless it is a partial offer and shareholder approval for a lesser percentage is obtained.
- Self-defeating conditions prohibited — Although an offer can be conditional, the conditions cannot depend on the judgment of the offeror or be within their power or control. This requirement is intended to prevent offers being conditional on 'due diligence'.
- Variations — The Code allows offers to be varied but only to increase the consideration, to add a cash component to the consideration, to add to the offer a cash alternative, and to extend the offer.
- Defensive tactics — The Code restricts tactics by the target company directors that might 'frustrate' an offer, except in limited circumstances. The drafting of this provision is extremely wide and does not specify what types of action are restricted.

The 'notice and pause' requirements of the NZSX/NZDX Listing Rules apply to issuers who are not code companies under the Takeovers Code (ie, listed unit

trusts and group investment funds). These requirements (which must be included in listed issuers' constitutions) apply to 'restricted transfers' of units quoted on the NZX. 'Restricted transfers' are transfers that would, alone or with one or more contemporaneous or subsequent transfers that comprise part of a scheme or linked transactions, result in the votes controlled by any person (or group of associated persons) of any class of quoted units:

- Exceeding 20 per cent of the votes attached to that class; or
- If the person (or persons) controls 20 per cent or more of the votes, increasing by more than five per cent in any period of 12 months above the number of votes controlled at the time that person (or persons) gave its last notice under the notice and pause requirements for that class of quoted equity securities.[109]

Bidders must give notice to the listed issuer and to the NZX of matters such as the price, material conditions, maximum number of securities to which the proposal relates, the identity of persons expected to acquire relevant interests as a result, the number of units which the bidder and associated persons will hold, the times the transfers are intended to occur, and how the transfers are to be effected (eg, through NZX's order matching market, by widespread direct offer, or by private treaty).[110]

Notice must be given at least 15 business days before the transfer if any offeree is an insider, or otherwise at least three business days before such time.[111] Where no offeree is an insider and the transfer is effected on-market, subject to certain conditions, the bidder need give only one business day's notice. Directors of a listed issuer the subject of such a notice must give notice as soon as possible (and within the 15-day, three-day, or one-day period), stating:

- Whether any director (or associated person of a director) is expected to be a transferee;
- Whether any director has a possible conflict of interest;
- Whether there is any relevant information on the issuer likely to be available to any transferee not generally available to the market;
- Whether there is any undisclosed relevant information which should materially affect the decision of a reasonably informed prospective transferor and whether the transfer would be more or less desirable as a result; and
- The timing and significance of any further action, investigation, report, or disclosure by any directors.[112]

If any transferee is an insider, the directors must commission an appraisal report on the transfer to be released to relevant security holders or to the NZX (unless all transferors waive this requirement, or a majority of the disinterested directors

109 NZSX/NZDX Listing Rules, rule 4.5.
110 NZSX/NZDX Listing Rules, rule 4.5.2.
111 NZSX/NZDX Listing Rules, rule 4.5.3.
112 NZSX/NZDX Listing Rules, rules 4.5.6 and 4.5.7.

certify that in their opinion the cost and difficulty of providing it outweigh the benefit). The appraisal report is made by an independent, appropriately qualified person and states a variety of prescribed matters, including whether the consideration and terms and conditions of the transaction are fair to unit holders (other than those associated with associated persons).[113]

Constitutions of issuers listed on the NZX may modify the notice and pause provisions to apply only when the transferees are insiders ('insider only' provisions) or adopt 'minority veto' provisions which, among other things, require the longer notice period even where no transferee is an insider, require equal offers to all holders of the relevant securities or on-market transactions (unless holders agree otherwise), and require the directors to commission an independent report on the proposal.[114] Severe penalties can be imposed for breach of the notice and pause requirements, including the defaulter not being able to vote its securities and the defaulters' securities being sold.[115]

When a person (or group of associated persons) acquires beneficial ownership of 90 per cent or more of a class of quoted units, it must give an acquisition notice to other holders, the issuer, and the NZX, specifying that fact within 20 business days and that it intends to acquire the remaining securities or that remaining holders may require it to buy their securities, and the consideration for remaining securities. The majority holder, before giving the acquisition notice, must give the NZX an independent report confirming that the consideration is fair. The other holders may challenge the amount of consideration.[116]

Section 47 of the Commerce Act 1986 prohibits a person acquiring shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition. Section 47 of the Commerce Act 1986 also applies to acquisitions of assets.

The Overseas Investment Act 2005 regulates certain transactions involving "overseas persons". Consent from the Overseas Investment Office is required where an overseas person acquires a 25 per cent or more direct or indirect ownership and/or control of interests in "significant business assets" (with assets of NZ $100 million being the proxy for "significant business assets)"; "sensitive" and "special" New Zealand land; farm land; or fishing quota. Note that there are a number of exceptions to this requirement.

The Overseas Investment Act 2005 defines 'Overseas persons'.[117] The purpose of the definition is to provide that persons are overseas persons if they themselves are overseas persons (for example, not a New Zealand citizen or resident or, for companies, incorporated overseas) or they are 25 per cent (or more) owned or controlled by an overseas person or persons.

113 NZSX/NZDX Listing Rules, rules 1.7, 4.5.8, and 4.5.9.
114 NZSX/NZDX Listing Rules, rules 4.3, 4.4, and 4.6.
115 NZSX/NZDX Listing Rules, rule 4.7.
116 NZSX/NZDX Listing Rules, rule 4.8.
117 Overseas Investment Act 2005, s 7.

The Overseas Investment Act acknowledges that it is a privilege for overseas persons to own or control sensitive New Zealand assets and requires certain overseas investments to meet criteria for consent. Section 14(1) of the Overseas Investment Act 2005 requires that the Minister of Finance must grant consent to applications for consent to overseas investments in significant business assets if the following criteria are satisfied:

- The directors collectively have business experience and acumen relevant to the overseas investment;
- A financial commitment to the overseas investment has been demonstrated;
- The directors are of good character; and
- The directors are not of the kind referred to in section 7(1) of the Immigration Act 1987 (which section includes persons who have committed an offence punishable by more than 12 months' imprisonment, who have been deported from New Zealand, or who are believed to have engaged in an act of terrorism).

Under the Commerce Act 1986, buyers need not file any application with the Commerce Commission for the acquisition of shares. However, a buyer may choose to seek either an acquisition that will not have, or would not be likely to have, the effect of substantially lessening competition in a market or an authorisation, granted by the Commerce Commission, if it is satisfied that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted.[118]

A party cannot be liable under section 47 of the Commerce Act or the general prohibition in the Act on anticompetitive trade practices if it has a clearance or authorisation.[119] Buyers often seek clearances if there is any possibility of section 47 applying, especially if the acquisition is in an industry in which the Commerce Commission has indicated that it will take a special interest.

Clearances are often granted within the initial 10-working-day time limit in section 66(3) of the Commerce Act 1986 (although this period is often extended by agreement between the Commerce Commission and the applicant if the acquisition raises any significant issues).

Applications are made to the Commerce Commission, using a standard form published by the Commerce Commission, with an application fee of NZ $2,300 for a clearance or NZ $23,000 for an authorisation. The relevant Minister may exempt any person, transaction, interest, right, or assets (or class of persons, transactions, interests, rights, or assets) from the requirement to obtain consent or from the definition of overseas person or associate or associated land under the Overseas Investment Regulations 2005.

118 Commerce Act 1986, ss 66 and 67.
119 Commerce Act 1986, s 69.

Jurisdictional Conflicts

In General

In dealing with jurisdictional conflicts, the principles of New Zealand 'conflict of laws' (otherwise known as private international law) determine three questions, namely:

- Will the dispute be determined by a New Zealand court?[120]
- If the dispute has already been determined by a court elsewhere, will the judgment be treated as decisive in New Zealand (and be enforced, or give rise to an estoppel so that the same issues cannot be litigated in New Zealand)? and
- If a New Zealand court determines the dispute, which system of law will apply to questions of law?[121]

Will the Dispute Be Determined by a New Zealand Court?

Service of Proceedings

The New Zealand High Court has jurisdiction if:

- The proceedings are within the subject matter jurisdiction of the court;
- In the case of parties that cannot be served in New Zealand, the High Court Rules allow service outside New Zealand; and
- The documents are served by personal service, under an agreement for service or according to a court order for substituted service.[122]

A company incorporated outside New Zealand and carrying on business in New Zealand may be served in New Zealand by:

- Delivery to a person named in the overseas register as a director of the company and who is resident in New Zealand;
- Delivery to a person named in the overseas register as being authorised to accept service in New Zealand of documents on behalf of the company;
- Delivery to an employee of the company at the company's place of business in New Zealand or, if the company has more than one place of business in New Zealand, at the company's principal place of business in New Zealand;
- Service in accordance with any directions as to service given by the court having jurisdiction in the proceedings; or
- Procedure in accordance with an agreement made with the company.[123]

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120 This depends on whether the New Zealand court has jurisdiction and whether New Zealand is the appropriate forum.

121 Goddard, 'Conflict of Laws: Jurisdiction and Foreign Judgments', The Laws of New Zealand (online ed), at para 1.

122 Goddard, 'Conflict of Laws: Jurisdiction and Foreign Judgments', The Laws of New Zealand (online ed), at para 14.

In certain circumstances, a person may be served outside New Zealand without first obtaining the leave of the court. In other cases, the High Court may grant leave for service outside New Zealand.[124]

Forum Conveniens

Even if it has jurisdiction, a New Zealand court may decline to hear and determine proceedings if New Zealand is not the *forum conveniens*. The *forum conveniens* is 'the forum in which the case can be suitably tried for the interests of all parties and for the ends of justice'.[125]

Arguments that New Zealand is not the *forum conveniens* can be raised by a person on whom proceedings have been served, to object to the jurisdiction of the New Zealand court or, alternatively, to seek a stay of proceedings, or a person against whom proceedings are issued in New Zealand as of right or who has submitted to the New Zealand court's jurisdiction to seek a stay of proceedings.

If courts in more than one country have jurisdiction, the *forum conveniens* will be that with which the action has the most real and substantial connection.[126] The New Zealand court will be the *forum conveniens* if it is the only court with the power to grant the relief sought by the plaintiff, which may well be the case in some securities litigation (eg, proceedings seeking various orders under the Securities Markets Act 1988).

The New Zealand Court of Appeal has considered such issues in proceedings under the Securities Act 1978. In *Society of Lloyd's & Oxford Members' Agency Ltd* v *Hyslop*,[127] the plaintiff had become a member of the Society of Lloyd's and, through her managing agents, had entered into underwriting contracts as a member of various syndicates.

When these contracts made substantial losses and her managing agents sought to recover from her, she brought proceedings alleging, among other things, a breach of the Securities Act 1978. The New Zealand Court of Appeal held that the United Kingdom was the more appropriate forum, and it stayed the New Zealand proceedings (even though the New Zealand Courts appeared to have jurisdiction). The Court of Appeal took into account the following factors:

- Clauses in all relevant documents conferred exclusive jurisdiction on the English courts and applied English law as the proper law of the contract (and had been upheld in other jurisdictions);

123 Companies Act 1993, s 389.
124 High Court Rules, rules 6.27 and 6.28.
125 Lord Goff of Chieveley, *The Spiliada* [1986] 3 All ER 843, at p 858, approved in *McConnell Dowell Constructors Ltd* v *Lloyd's Syndicate* 396 [1988] 2 NZLR 257, at pp 273, 280, and 281.
126 *Oilseed Products (NZ) Ltd v HE Burton Ltd* (1987) 1 PRNZ 313, at p 316.
127 *Society of Lloyd's & Oxford Members' Agency Ltd v Hyslop* [1993] 3 NZLR 135.

- Eighty per cent of Lloyd's members were in England, so Lloyd's as regulator of the market could not deal equitably with all members if disputes were litigated in various jurisdictions;
- Many writs had been issued by others in England, so that many of the issues in the current proceedings would be considered in English proceedings and the outcome of such proceedings would affect the plaintiff;
- Most of the evidence and witnesses were in England;
- The basic documentation was in England and the crucial contracts were substantially performed there;
- The central fund and assets were in England;
- The relief sought in New Zealand would affect not only Lloyd's and Oxford, but also other Lloyd's members;
- English laws (such as the Lloyd's Act 1982) were relevant;
- There was particular public interest in England in Lloyd's matters; and
- Senior English judges were used to interpreting New Zealand legislation and, in any appeal from the New Zealand Court of Appeal, English Law Lords (sitting as the Privy Council) would determine New Zealand proceedings.

While some of the above factors may have been specific to the facts in that case, the *Lloyd's* case gives some guidance on New Zealand courts' view of the significance of the Securities Act 1978 in determining conflict of law issues. The then President of the Court of Appeal, Cooke P, stated:

'[T]he Securities Act may be seen as basically similar to securities legislation in other countries. Canadian, Australian and United States Courts have been content to leave questions concerning Lloyd's membership to the English Courts. The Securities Act 1978 is not distinctively New Zealand legislation, although no doubt it has some distinctive New Zealand features.

Whether any such features are significant in relation to the present case could not be determined without in-depth comparisons that, understandably, were not attempted in the argument of the present appeals. I am sure that the better course, in accordance with international trends, is to leave the respondent's claim against the present appellants to be tried in England, assuming that she pursues it there.'[128]

While the significance of the Securities Act 1978 in any particular proceedings will depend on all the circumstances of the particular case, the Lloyd's case suggests that New Zealand courts will not necessarily hold that this legislation must be interpreted by a New Zealand court.

128 *Society of Lloyd's & Oxford Members' Agency Ltd* v *Hyslop* [1993] 3 NZLR 135, at p 138.

Will a Foreign Judgment Be Recognised as Decisive in New Zealand?

Methods of Enforcing Judgments

In General. Foreign judgments may be enforced in New Zealand following registration under the Reciprocal Enforcement of Judgments Act 1934, under an action at Common Law, or by registering a memorial of the judgment under section 56 of the Judicature Act 1908.

Registration under the Reciprocal Enforcement of Judgments Act 1934. The Reciprocal Enforcement of Judgments Act 1934 is based on the United Kingdom's Foreign Judgments (Reciprocal Enforcement) Act 1933. Many other countries have similar legislation.

A judgment creditor under a judgment of a court in an overseas country to which the Reciprocal Enforcement of Judgment Acts 1934 applies may register that judgment under the procedure in the Act. At the time of writing, the Reciprocal Enforcement of Judgments Act 1934 applies to judgments of various courts in:

- Australia;
- Bechuanaland (Botswana);
- Belgium;
- Cameroon;
- Ceylon;
- Corsica;
- England;
- Fiji;
- France;
- Gilbert & Ellice Islands (Kiribati & Tuvalu);
- Hong Kong;
- India;
- Malaysia;
- Nigeria;
- Norfolk Island;
- Northern Ireland;
- Pakistan;
- Papua New Guinea;
- Sarawak;
- Singapore;
- Solomon Islands;
- Sri Lanka;
- Swaziland;
- Tonga;

- Scotland;
- Wales; and
- Western Samoa.

Subject to the procedure for setting aside of registration, a registered judgment is, for the purposes of enforcement, of the same force and effect as if the judgment had been a judgment originally given in the High Court. Proceedings may be taken on a registered judgment, the sum for which a judgment is registered will carry interest, and the High Court has control over the enforcement of a registered judgment. The judgment must be capable of being enforced in the country of the original Court.[129]

Actions at Common Law. If not covered by the Reciprocal Enforcement of Judgments Act 1934, a foreign judgment may be able to be enforced at Common Law. The plaintiff may sue on the foreign judgment itself or on the original cause of action.

The New Zealand court will enforce a foreign judgment *in personam* if New Zealand law recognises the foreign court's jurisdiction over the defendant, and the judgment is for a definite sum and is a final judgment.[130]

Registering a Memorial under Section 56 of the Judicature Act 1908. Section 56 of the Judicature Act 1908 applies to money judgments not covered by the Reciprocal Enforcement of Judgments Act 1934 of courts of any territories under the sovereignty of the Crown (including the United Kingdom) and Commonwealth countries.

A memorial of such a judgment, with the particulars specified in section 56 and sealed by the original court, may be filed in the office of the New Zealand High Court. The High Court may make an order for issuing execution on the judgment.

Which System of Law Will a New Zealand Court Use to Determine Questions of Law?

By way of general comment, a New Zealand court will apply New Zealand law unless it is established that the law of another country should apply.

129 Reciprocal Enforcement of Judgments Act 1934, s 4(2) and (2A).

130 Goddard, 'Conflict of Laws: Jurisdiction and Foreign Judgments', The Laws of New Zealand (online ed), at paras 62–70.

Nigeria

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Nigeria

KPMG Professional Services
Lagos, Nigeria

Introduction

Regulatory System

The origin of the Nigerian capital market can be traced to the colonial era.[1] In 1946, the British Colonial government became aware that the absence of a capital market made it difficult to raise long-term funds necessary for the development of capital projects. Consequently, the colonial administration established a 10-year development plan for Nigeria under which long-term funds were raised in the United Kingdom and Nigeria for financing small community improvement projects, educational research, and infrastructure and to induce private sector industrial and agricultural development.

Thus, a Local Loans Board was established in 1946, and it was followed by the establishment of Regional Loans Boards in 1949. Thereafter, development planning was by five-year federal and regional plans, and savings were mobilised through the Regional Marketing Boards, as well as non-bank financial intermediaries such as the Lagos Building Society and the Post Office Savings Bonds Scheme.[2]

Although a Stock Exchange commenced operations in 1961, securities regulation started informally in 1962 with the activities of a non-statutory body, which was referred to as the Capital Market Committee. This was followed by a series of landmark events, fiscal and monetary policies, and developments in the legal framework, which culminated in the establishment of the present-day Securities and Exchange Commission.

The aim of the regulatory system is to regulate the operations, infrastructure, investments, and trading in securities in the Nigerian capital market. The Nigerian capital market affords corporate bodies, and the various tiers of government, the opportunity to raise long-term funds at a relatively cheaper cost through the issuance of securities to the public.[3] The primary objective of the regulatory system is to ensure that the capital market is fair, efficient, and transparent, thereby providing adequate protection to investors and sustaining confidence in the market. The Nigerian capital market has become

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1 This chapter was prepared by Oluwole Obayomi, Ajibola Olomola, Afolabi Elebiju, Adesuwa Ladoja, Ngozi Okonkwo, Oluseye Arowolo, Ademidun Edosomwan, Bukola Kola-Olukotun, Michael Ango, Ruth Adegbola Uche Enunwaand Abu Sadiq.

2 Abdulai, 'History of the Nigerian Capital Market — the Legal Perspective', *Seminar on Securities Laws and the Capital Market* (5 and 6 December 2001), at p 7.

3 Ndanusa, 'Implications of the Judicial Decisions on Capital Market in the Nigerian Economy', *Seminar on Securities Laws and the Capital Market* (5 and 6 December 2001), at p 2.

increasingly vibrant and is ranked second after South Africa on the African continent. Its market capitalisation has grown from N 979.13 billion in 2003 to an estimated N 1.9 trillion in June 2004, and N 2.567 trillion in October 2005.

In the Nigerian legal framework, the term 'securities'[4] includes:

- Debentures, stocks, or bonds issued or proposed to be issued by a government;
- Debentures, stocks, shares, bonds, or notes issued or proposed to be issued by corporate or unincorporated entities;
- Any right or option in respect of any such debentures, stocks, shares, bonds, or notes;
- Futures contracts;
- Bills of exchange;
- Promissory notes or certificates of deposit issued by a bank which has a tenure of not less than nine months;
- Any of the above items transferred by means of any electronic mode approved by the Securities and Exchange Commission and which may be deposited, kept, or stored with any licensed depository or custodian company; and
- Derivatives, securities debt, or any other instruments registered by the Securities and Exchange Commission.[5]

Legal Sources

In General

The sources of Nigerian securities law can be classified as follows:

- Statutes;
- Rules and regulations;
- Listing requirements; and
- Judicial decisions and rulings.

Statutes

Lagos Stock Exchange Act Number 14 of 1961. The Lagos Stock Exchange was established in 1960 but commenced operations on the enactment of the Lagos Stock Exchange Act in 1961. When the Lagos Stock Exchange Act commenced securities exchange operations in 1961, it had 19 securities listed for trading. Hitherto, almost all formal savings and deposits went through the banking system while major capital balances were invested for the country by Great Britain on the London Stock Exchange.[6]

4 Investments and Securities Act, 1999.
5 Securities and Exchange Commission Rules and Regulations, rule 208, part F1.
6 See http://www.nigeriabusinessinfo.com/nse.

In 1976, a Federal Commission recommended that there should be a single National Stock Exchange. Thus, the name of the Lagos Stock Exchange Act was changed to the Nigerian Stock Exchange by statute in 1977. The Lagos Stock Exchange Act was repealed in 1999 by section 263(1) of the Investments and Securities Act, 1999.

Capital Issues Commission Act Number 14 of 1973. The *ad hoc* Capital Issues Committee was established in 1962 by the Central Bank of Nigeria to monitor the operations of the Lagos Stock Exchange and the Nigerian capital market.

In 1973, the federal government upgraded the Committee to a 'Capital Issues Commission' under the enabling Capital Issues Commission Act as a result of the increasing awareness of the importance of securities regulation. The Capital Issues Commission Act was repealed and superseded by the Securities and Exchange Commission Act Number 71 of 1979, which was amended and re-enacted in 1988 and later repealed and replaced with the Investments and Securities Act, 1999.

The Securities and Exchange Commission Act Number 71 of 1979. The Securities and Exchange Commission Act of 1979 established the Securities and Exchange Commission and vested it with the functions of determining the price at which the securities of a company are to be sold to the public, the timing and amount of any subsequent issues, registration of all securities proposed to be offered for sale to the public, and generally maintaining surveillance over the securities market.

The primary functions of the Securities and Exchange Commission under the Act were similar to those of the Capital Issues Commission. However, unlike the Capital Issues Commission, the Securities and Exchange Commission also was responsible for the registration of new stock exchanges and the allotment of shares in public companies. As a result of the shortcomings of the Securities and Exchange Commission Act of 1979, particularly the absence of sufficient adjudicatory powers, the Securities and Exchange Commission Act of 1988 was enacted to replace the 1979 Act.

The Securities and Exchange Commission Act Number 29 of 1988. The Securities and Exchange Commission Act conferred the Securities and Exchange Commission with additional adjudicatory powers to conduct hearings into apparent violations of the securities law.

It also empowered the Securities and Exchange Commission to suspend erring capital market operators and to revoke the registration of a registered operator (with prior approval from the Minister of Finance). The Securities and Exchange Commission Act of 1988 was repealed by section 263(1)(c) of the Investments and Securities Act Number 45 of 1999.

Companies and Allied Matters Act, Cap 59, Laws of the Federation of Nigeria 1990. The Companies and Allied Matters Act was promulgated to provide for the incorporation of companies, registration of business names, and incorporation of trustees of certain communities, bodies, and associations. Part XVII of the Companies and Allied Matters Act also

contained provisions related to certain dealings in companies' securities. This was an unnecessary duplication of the provisions of the Securities and Exchange Commission Act of 1988. Part XVII of the Companies and Allied Matters Act has now been repealed by section 263(1)(d) of the Investments and Securities Act Number 45 of 1999.

By section 54 of the Companies and Allied Matters Act, foreign companies that wish to do business in Nigeria must incorporate a local company for that purpose. Branch registration is not permitted.

Prior to 1990, companies were regulated by the Companies Act Number 51 of 1968. This was promulgated to provide a more modern legislation because the previous legislation was inadequate to cope with the growth of economic activities in Nigeria. The Companies Act contained many provisions that were perceived at that time to be far reaching, eg, the provision to publicise the affairs of the company in the interest of the shareholders and the general public.[7]

Nigerian Investment Promotion Commission Act Number 16 of 1995. The Nigerian Investment Promotion Commission Act guarantees foreign investors the unrestricted transferability of dividends or profits (net of taxes) attributable to foreign investment in Nigeria, payments in respect of foreign loan servicing, and capital repatriation in the event of liquidation.[8] The only restrictions on investment relate to the items on the negative list, which are reserved exclusively for the government. The negative list includes enterprises engaged in activities involving:

- Production of arms and ammunition;
- Narcotics and psychotropic substances; and
- Military, para-military, police, customs, immigration, and prison service uniforms and accoutrements.[9]

The Nigerian Investment Promotion Commission Act also guarantees foreign direct investment against all forms of expropriation or nationalisation by the federal government.[10] Disputes arising between foreign investors and any government of the Federation would be settled through mutual discussions. However, on failure to reach an agreement, the aggrieved party may resort to arbitration within the framework of the relevant bilateral or multilateral agreement on investment protection to which the federal government and the investor's country are parties.[11] The Nigerian Investment Promotion Commission functions as a liaison between investors and ministries, government departments, institutional lenders, and other institutions concerned with investments.

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7 Orojo, *Nigerian Company Law and Practice*, at p 7.
8 There is currently no ceiling on profits distributable as dividends provided that such distributions are not paid out of capital.
9 Nigerian Investment Promotion Commission Act, s 32.
10 Nigerian Investment Promotion Commission Act, s 25.
11 Nigerian Investment Promotion Commission Act, s 26.

Foreign Exchange (Monitoring and Miscellaneous Provisions) Act 1995 and Central Bank Guidelines and Circulars. The Foreign Exchange (Monitoring and Miscellaneous Provisions) Act 1995 (FEMMP) further liberalised the Nigerian foreign exchange regime subsequent to the repeal of the Exchange Control Act 1962, the Exchange Control (Anti-Sabotage) Act 1984, the Foreign Currency (Domiciliary Accounts) Act 1985, and the Second Tier Foreign Exchange Market Act 1986, which hitherto restricted free dealings in foreign exchange.

The Foreign Exchange (Monitoring and Miscellaneous Provisions) Act 1995 and the Central Bank of Nigeria (CBN) Guidelines and Circulars (as revised) regulate foreign exchange transactions. Dealings in foreign exchange are now generally liberalised. Any eligible transaction supported by appropriate documentation qualifies for foreign exchange purchase and/or remittance through the Inter-Bank Foreign Exchange Market (IFEM), currently conducted by the CBN through the Dutch Auction System (DAS). Eligible transactions include purchase of equipment and materials, remittance of expatriate salaries, and payment for services rendered by foreign service providers.

The CBN also is able to review and approve, on a case-by-case basis, any application for a foreign exchange transaction which is not included in the Guidelines. Holders of foreign currency domiciliary accounts are allowed unrestricted access to funds in their accounts, which can be transferred within and outside Nigeria to settle third-party obligations.

Investments and Securities Act Number 45 of 1999. After several studies and review of the securities market, and principally on the recommendations of the Dennis Odife Panel on the Review of the Nigerian Capital Market in 1996 ('the Odife Report'), the Investments and Securities Act was enacted in 1999 as the primary legislation governing the Nigerian capital markets.

The Investments and Securities Act is a consolidation of laws and regulations that were hitherto contained in various pieces of legislation, and it sought to resolve previously contradictory and outdated provisions in that legislation. The Investments and Securities Act introduced two novel features in securities regulation in Nigeria, namely:

- The requirement that solicitors and other professionals who wish to act as consultants in the capital market must be registered with the Securities and Exchange Commission; and
- The establishment of the Investments and Securities Tribunal (the Tribunal).[12]

The Tribunal was inaugurated on 19 December 2002 and is headed by Dr Nnenna Orji, a lawyer and retired Director of the Securities and Exchange Commission.

Specifically, the Tribunal has powers to adjudicate on matters relating to the interpretation of the Investments and Securities Act, disputes between capital market operators and the Securities Exchanges or Capital Trade Points, disputes between capital market operators,

12 The Tribunal is made up of nine Capital Market Assessors appointed by the Minister of Finance. The Tribunal is vested with powers to adjudicate on disputes and controversies that arise under the Investments and Securities Act; Investments and Securities Act, s 234.

disputes between capital market operators and their clients, and disputes between quoted companies and the regulators or the Securities Exchanges.[13] Dissatisfied parties may make appeals to the Court of Appeal and, thereafter, the Supreme Court.[14]

Rules and Regulations

The Investments and Securities Act grants the Securities and Exchange Commission general and specific rule-making authority.[15] To carry out the objectives of securities regulation under the Investments and Securities Act effectively and after consultations with capital market operators and participants, the Securities and Exchange Commission published the Securities and Exchange Commission Rules and Regulations.

Since the publication of the original Rules in 2002, the Securities and Exchange Commission published amendments in December 2003 and August 2005. The Commission has yet to consolidate all the amendments since 2003 into a single document.

The Rules and Regulations govern various issues including securities exchanges, capital market operators, offer of securities for sale or subscription, mergers, acquisitions and combinations, collective investment schemes, investors' protection fund, and borrowing by states and/or local government agencies.

Listing Requirements

The Nigerian Stock Exchange has formulated general and specific listing requirements for public liability companies, which have been codified as the Rules Governing Listing on the Nigerian Stock Exchange (the 'Rules'). A company may apply for listing in any of the following markets:

- Main Market or First-Tier Securities — Only matured companies that meet all of the Nigerian Stock Exchange's listing requirements qualify for listing on the Main Market;
- Second-Tier Market — The Second-Tier Market is for companies that do not yet qualify for listing on the Main Market; and
- Unit Trust and Venture Capital Market — The Unit Trust and Venture Capital Market is for listing of funds and schemes that involve public participation.

The Rules also provide for the following additional matters:

- Securities of companies whose capital is not already listed on the Exchange;
- Securities of companies part of whose capital is already listed on the Exchange;
- Contents of the prospectus for companies whose capital is not listed on the Exchange;
- Contents of the prospectus for companies part of whose capital is already listed on the Exchange;

13 Investments and Securities Act, s 234.
14 Although the status of the Tribunal has not been challenged judicially, it is likely to be subject as well to the supervisory jurisdiction of the High Courts by means of judicial review.
15 Investments and Securities Act, ss 258 and 261.

- Takeovers and mergers;
- Contents of prospectus for Unit Trusts; and
- Securities issued by statutory bodies.

Judicial Decisions and Rulings

One of the notable judicial decisions on securities law and regulation is that of the Court of Appeal in *Societe Generale Bank Nigeria Limited* v *the Securities and Exchange Commission*.[16] The Court of Appeal held that the Securities and Exchange Commission approval was required for a valid transfer of shares in any company with alien participation (whether public or private) to any person, whether Nigerian or non-Nigerian.

This judicial decision has now been superseded by the provisions of the Investments and Securities Act, which no longer require Securities and Exchange Commission approval for transfer of shares in companies with alien participation.[17]

The issue of the competence of the Nigerian Stock Exchange to suspend the registration of a person's securities was resolved in *Owena Bank* (*Nigeria*) *Plc* v *Nigerian Stock Exchange Ltd*.[18] Here, the Supreme Court reversed the decision of the Administrative Hearing Committee of the Nigerian Stock Exchange to suspend the registration of, and trading in, Owena Bank's securities until the transfer of its 23.7 million shares duly transacted on the floors of the Nigerian Stock Exchange was effected. This was on the basis that the suspension was *ultra vires* the provisions of the Securities and Exchange Commission Act of 1988, which conferred the Securities and Exchange Commission, and not the Nigerian Stock Exchange, with the power to suspend the registration of any person's securities.

Regulatory Authorities

The Securities and Exchange Commission

The Securities and Exchange Commission is the apex regulatory institution of the Nigerian capital market and the principal adviser to the Nigerian government on capital market issues. The mission of the Securities and Exchange Commission is 'to develop and regulate a capital market that is dynamic, fair transparent and efficient, to contribute to the nation's economic development', while its vision is 'to be Africa's leading capital market regulator'.

16 *Societe Generale Bank Nigeria Limited* v *the Securities and Exchange Commission*, *Securities Law Report*, vol 1 (1992), at p 1.

17 Securities and Exchange Commission Act, 1988, s 7, required prior Securities and Exchange Commission approval for alien participation in Nigerian companies. This requirement has been repealed by the Investments and Securities Act.

18 *Owena Bank* (*Nigeria*) *Plc* v *Nigerian Stock Exchange Ltd* (1997) 8 NWLR (pt 515).

To this end, the Securities and Exchange Commission is empowered to make rules and regulations, ensure compliance with the provisions of the Investments and Securities Act and, where necessary, impose sanctions on erring operators and participants in the capital market. Part II, section 8, of the Investments and Securities Act empowers the Securities and Exchange Commission to:

- Regulate investments and securities business in Nigeria;
- Register all securities to be offered for sale or subscription to the public;
- Register the exchanges where securities are to be bought or sold;
- Register all operators in the market, eg, stockbrokers, registrars, issuing houses, investment advisers, portfolio managers, and capital market consultants;
- Register all securities traded on the exchanges;
- Regulate mergers, acquisitions, and all forms of business combinations;
- Regulate collective investment schemes;
- Register rotating savings schemes, such as *esusus* and *adashes*;[19]
- Facilitate the establishment of a nation-wide system for securities trading in the Nigerian capital market to protect investors and maintain fair and orderly markets;
- Facilitate the linking of markets in securities through modern communication and data processing facilities to foster efficiency, enhance competition, and increase the information available to brokers, dealers, and investors;
- Act in the public interest having regard to the protection of investors and maintenance of fair and orderly markets and, to this end, establish a nation-wide trust scheme to compensate investors whose losses are not covered under the investors' protection funds administered by securities exchanges and capital trade points;
- Keep and maintain separate registers of foreign direct investments and foreign portfolio investments;
- Register and regulate central depository companies, clearing and settlement companies, custodians of securities, credit rating agencies, and intermediaries;
- Protect the integrity of the securities market against abuses arising from the practice of insider trading;
- Act as a regulatory apex organisation of the Nigerian capital market, including the promotion and registration of self-regulatory organisations and capital market trade associations to which it may delegate its powers;
- Conduct research into all or any aspect of the securities industry;
- Prevent fraudulent and unfair trade practice relating to the securities industry; and
- Perform such other functions and exercise such other powers not inconsistent with the Act as necessary or expedient for giving full effect to the provisions of the Act.[20]

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19 These are examples of communal savings schemes. By seeking to incorporate these informal transactions into the mainstream of securities regulation, the Investments and Securities Act has clearly set a difficult task for the Securities and Exchange Commission.

20 Investments and Securities Act, 1999, part II, s 8.

Nigerian Stock Exchange

The Nigerian Stock Exchange is a self-regulatory organisation governed by the Nigerian Stock Exchange Council. The Nigerian Stock Exchange Council has an upper limit of 25 members comprising individuals, institutions, and stock broking companies. The Council makes decisions on the policies of the Nigerian Stock Exchange, which are executed by the executive officers headed by the Director-General.

The Nigerian Stock Exchange provides a marketplace for the buying and selling of securities issued by public companies, governments, and statutory bodies on the basis of a wide distribution of ownership and adequate disclosure of information.[21] The Nigerian Stock Exchange operates an Automated Trading System with more than 260 listed companies. Companies that wish to be admitted to the official list of the Nigerian Stock Exchange must comply with its listing requirements, the Investments and Securities Act, and the Securities and Exchange Commission Rules and Regulations.

Abuja Commodity Exchange

In 1999, the federal government of Nigeria announced the creation of the Abuja Stock Exchange[22] in the Federal Capital Territory of Abuja. The creation of the Abuja Stock Exchange was criticised by the Nigerian Stock Exchange and described as an unnecessary duplication of exchanges at a time when exchanges in other countries were consolidating.

However, with the registration and commencement of operation of the Abuja Stock Exchange in 2000, Nigeria became a multiple-exchange environment, which necessitated revisions to the Rules and Regulations on multiple trading and dual listings of securities. The rules on dual listings provide for securities on one exchange to be listed and traded on another, if the issuer so desires and meets the listing requirements of the Exchanges involved.

On 8 August 2001, the federal government revised its decision on the establishment of the Abuja Stock Exchange, and the Exchange was converted to the Abuja Commodity Exchange. The Abuja Commodity Exchange has been mandated to assist the federal government in its drive to expand the horizon and contribution of Nigeria's non-oil exports to the national purse.

In furtherance of its privatisation plans, the federal government intends to offer 51 per cent of the shares of the Abuja Commodity Exchange for sale to a core investor or a consortium of foreign or domestic investors. The remaining shares would be sold to members of the Nigerian public.

Investments and Securities Tribunal

The Investments and Securities Act provides for the establishment of an Investments and Securities Tribunal to handle capital market disputes expeditiously.

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21 Rules Governing Listing on the Nigerian Stock Exchange, at p IV.

22 The Abuja Stock Exchange was granted a two-month provisional renewal licence. The full licence was issued pending the fulfillment of registration requirements.

The Tribunal was inaugurated in December 2002 and has commenced hearing of investment disputes. However, the Securities and Exchange Commission has sought to ensure the continuity of the erstwhile Administrative Hearing Committee by providing for its establishment under Rule 313, Part L, of the Securities and Exchange Commission Rules and Regulations, as amended.

The Administrative Proceedings Committee will have authority to resolve disputes and complaints arising from capital market operators and institutions in the market who are perceived to have violated or have actually violated or threatened to violate the provisions of the Act and the Rules and Regulations made thereunder and such operators or persons against whom complaints and allegations have been made to the Commission.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. Under the Investments and Securities Act, securities exchanges and capital trade points may be registered with the Securities and Exchange Commission.[23] A Securities Exchange includes a Stock Exchange or an approved securities organisation such as a Commodity Exchange, Metal Exchange, Petroleum Exchange, and Options, Futures, and Derivatives Exchanges.[24]

On the other hand, capital trade points are defined as exchanges which constitute, maintain, or provide market facilities for bringing together purchasers and sellers of securities or for otherwise performing, with respect to securities, the functions commonly performed by a Securities Exchange.[25]

In Nigeria, the Nigerian Stock Exchange is the only domestic exchange that is currently mandated to trade in securities. A securities exchange is registered where the following is satisfactorily provided:

- Evidence of registration of the proposed Exchange as a Nigerian company, along with copies of the company's Memorandum and articles of association;
- Enacted or proposed by-laws or rules of conduct, codes of dealing, or other rules of the proposed Exchange; and
- Evidence of a minimum paid-up capital of N 500 million.[26]

The Securities and Exchange Commission is empowered by the Investments and Securities Act to have regulatory oversight of the Nigerian Stock Exchange particularly with regards to its manner of reporting off-market purchases. Capital market operators include

23 Investments and Securities Act, 1999, s 20(1).
24 Investments and Securities Act, 1999, s 28.
25 Investments and Securities Act, 1999, s 34.
26 Securities and Exchange Commission Rules and Regulations, rule 22.

securities dealers, stockbrokers, sub-brokers, jobbers, share transfer agents, bankers to share issue, market trustees of trust deeds, registrars to share issue, merchant bankers, issuing houses, underwriters, operators, portfolio managers, investment advisers, rating agencies, capital market consultants, and other such intermediaries associated with the securities industry.

An operator must be registered with the Securities and Exchange Commission before dealing in securities. Such registration, which is at the discretion of the Securities and Exchange Commission, is to ensure that only qualified and reputable persons and organisations are involved in dealings in securities.

The Securities and Exchange Commission has developed various registration requirements, depending on the activities to be carried out by the applicant. Thus, a single operator may be registered in various categories depending on the activities such operator intends to undertake on the capital market. The principle of universal registration is not applicable in Nigeria.

The Securities and Exchange Commission also requires brokers and dealers to be registered as members of one or more self-regulatory organisations. By virtue of the fact that the Nigerian Stock Exchange is the only exchange for trading shares in Nigeria, it qualifies as a self-regulatory organisation.[27] Brokers and dealers are registered by the Exchange. Dealers and brokers are required to be members of an Association of Securities Dealers to effect transactions in an over-the-counter market. The Securities and Exchange Commission is considering the registration of the Nigerian Association of Securities Dealers (NASD) as a self-regulatory organisation to establish an over-the-counter market for trading in the securities of public unquoted and quoted companies in Nigeria. The NASD also will have the mandate to streamline the operations of the market.

Registered members of the Nigerian Stock Exchange may have foreign equity participation or enter into any form of partnership with foreign stock-broking firms. Foreign stockbroker firms that wish to do business in Nigeria must incorporate a local subsidiary (which may be wholly owned by such firm). Such local subsidiary may then apply for membership of the Nigerian Stock Exchange subject to compliance with its rules and regulations, which include a capital base of at least N 40 million and the payment of the prescribed deposit into the Nigerian Stock Exchange Investors Protection Fund. The subsidiary company also will register with the Securities and Exchange Commission under the desired category as a capital market operator.

Central Securities Clearing System. To further improve the quality of its services, the Nigerian Stock Exchange incorporated a subsidiary clearing house, the Central Securities Clearing System in 1992. The clearing, settlement, and delivery transactions of the Nigerian Stock Exchange are now made electronically through the Central Securities Clearing System.

27 Securities and Exchange Commission Rules and Regulations, reg 42.

The Central Securities Clearing System was introduced to implement a computerised Stock Exchange Management System, which emphasises the immobilisation of share certificates in a central depository. The Central Securities Clearing System provides an integrated central depository, clearing (electronic/book-entry transfer of shares from seller to buyer), and settlement (payment for bought securities) for all stock market transactions. The Central Securities Clearing System also acts as a clearing and custodian agency for local instruments and issues central identification numbers to stockholders.

Electronic Trading Systems. The Nigerian Stock Exchange introduced the Automated Trading System in April 1999 to replace the call-over trading system. Stockbrokers now match bids and offers on the trading floors of the Nigerian Stock Exchange through a network of computers.

The Automated Trading System was introduced to facilitate a significant level of transparency, efficiency, and fairness in the stock pricing process. The Nigerian Stock Exchange has introduced the Remote Trading System to increase efficiency in securities trading and to obviate the need for dealers to consummate deals on the floor of the Nigerian Stock Exchange or any of its branches. Nigeria does not have a transborder electronic trading system.

The Central Securities Clearing System recently introduced a transaction verification procedure called 'Trade Alert' to prevent unauthorised trade in company securities by stockbrokers, to the detriment of investors. Trade Alert works by sending text messages to investors on their mobile telephones anytime there is a transaction on their accounts, to enable them to confirm the transaction or abort it, if it was carried out without their authorisation. Investors are thus able to monitor their transactions and stock balances on their accounts on a daily basis, and it is believed the resultant transparency would enhance the global attractiveness of the Nigerian capital market.[28]

The Abuja Commodities Exchange. The purpose of the Abuja Commodity Exchange is to assist the government in its drive to diversify the Nigerian economy by internationalising and standardising Nigeria's tradable commodities, such as cocoa, palm products, cotton, rubber, and non-ferrous metals. The Abuja Commodity Exchange has not yet commenced operations.

Off-Market Transactions. Stocks can be transferred outside the Nigerian Stock Exchange in cases of nominal transfers, and it also is possible to arrange negotiated deals such as divestitures by way of management buy-out.

Other than in these situations, off-market transactions are not permitted. Consequently, it is not possible to transfer regulated securities other than on the trading floor of the Exchange where such securities are registered.

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28 See http://www.nse-cscstradealert.com.

Securities

National Treatment and Reciprocity. 'Foreign investment' means any investment in securities involving foreign capital importation made by a foreign person (corporate body or individual) or by a Nigerian resident outside Nigeria. Generally, in Nigeria, investments are categorised as follows:

- Shares and stock in the share capital of a company;
- Debentures, including debenture stock, loan stock, bonds, certificates of deposit, and other instruments creating or acknowledging indebtedness, not being government and public securities;
- Loan stock, bonds, and other instruments creating or acknowledging indebtedness issued by or on behalf of a government, local authority, or public authority;
- Warrants or other instruments entitling the holder to subscribe for investment in shares and stock in the share capital of a company, debentures, or government and public securities;
- Certificates or other instruments which confer (a) property rights in respect of warrants or other instruments entitling the holder to subscribe for investment in shares and stock in the share capital of a company, debentures, or government and public securities, (b) any right to acquire, dispose of, underwrite, or convert an investment, being a right to which the holder would be entitled if he held any such investment to which the certificate or instrument relates, or (c) a contractual right (other than an option) to acquire any such investment otherwise than by subscription;
- Units in a collective investment scheme, including shares in or securities of an open-ended investment company;
- Options;
- Futures; and
- Other forms of investment or capital instrument within the meaning of investment generally.[29]

In 1995, the previous laws regulating foreign investment[30] were repealed, and the Nigerian Investment Promotion Commission Act and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act were enacted to enable Nigeria to compete favourably with other African countries for foreign direct investment. Hence, there are no restrictions on investments by foreign institutions and individuals,[31] except in the following sectors, which are prohibited to Nigerians and foreigners alike:

- Production of arms and ammunition;
- Production of, and dealing in, narcotic drugs and psychotropic substances;

29 Investments and Securities Act, 1999, Second Schedule.

30 These include the Nigerian Enterprises Promotion Act, 1989; Exchange Control Act, 1962; Exchange Control (Anti-Sabotage) Act, 1984; Industrial Development Co-Ordination Act, 1988; Foreign Currency (Domiciliary Account) Act, 1985; and Second-Tier Foreign Exchange Market Act, 1986.

31 Nigerian Investment Promotion Commission Act, 1995, ss 17, 18, and 32.

- Production of military and paramilitary wears and accoutrement, including those of the police, customs, immigration, and prison services; and
- Such other items as the Federal Executive Council may determine.

Any person (including foreigners) may invest or deal in all securities traded on the primary and secondary markets or by private placements in Nigeria, or any other money market instruments, whether or not denominated in foreign currency in Nigeria.[32] These securities, except in the case of private companies, are to be registered by the Securities and Exchange Commission in accordance with the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations.[33]

Portfolio investors subscribing in primary market securities are required to effect their transactions through capital market operators registered in Nigeria by the Securities and Exchange Commission. Those investing in the secondary markets are to effect transactions through licensed brokers/dealers on the floors of any of the Exchanges or through over-the-counter markets registered by the Securities and Exchange Commission.

Foreign investors investing foreign capital in the securities of public companies are required to do so through capital market operators registered by the Securities and Exchange Commission.[34] Furthermore, such investors are required to import the requisite foreign capital for such investments through an authorised dealer in foreign exchange and to obtain a Certificate of Capital Importation from the authorised dealer.[35] The Certificate of Capital Importation entitles the foreign investors to:

- Open a foreign currency domiciliary account with any authorised dealer for investment purposes;[36]
- Open a special non-resident Naira account to which could be credited all receipts from the capital inflows, proceeds from sale of securities, dividends, and interests;[37] and
- Make investments in securities in Nigeria out of the balances in the Naira account.[38]

The capital imported into Nigeria and invested in any securities or other investment, together with the capital gains, dividends, profits, or any interests attributable to the investment, may be repatriated at any time through an authorised dealer subject to the deduction of withholding tax.[39]

Foreign investors can divest their holdings in securities through the Exchange or on a recognised over-the-counter market with respect to unquoted securities traded on that market. Divestment of holdings in securities in any other public company can be done through the capital market operators registered by the Securities and Exchange Commission.

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32 Foreign Exchange Monitoring and Miscellaneous Provisions Act, 1995, s 26; Securities and Exchange Commission Rules and Regulations, s 209.
33 Securities and Exchange Commission Rules and Regulations, rule 209, part F1.
34 Securities and Exchange Commission Rules and Regulations, rule 210, part F1.
35 Foreign Exchange Monitoring and Miscellaneous Provisions Act, 1995, s 15(1) and (2).
36 Foreign Exchange Monitoring and Miscellaneous Provisions Act, 1995, s 17.
37 Securities and Exchange Commission Rules and Regulations, rule 212, part F1.
38 Securities and Exchange Commission Rules and Regulations, rule 212, part F1.
39 Foreign Exchange Monitoring and Miscellaneous Provisions Act, 1995, s 15(4).

Issuer Requirements. The Investments and Securities Act, 1999, section 29(1), precludes any person (including foreign institutional investors)[40] from dealing in securities, without a Certificate of Registration from the Securities and Exchange Commission. This requirement also applies to sponsors of venture capital funds or collective investment schemes, including mutual funds.

Recently, the Securities and Exchange Commission issued a new directive requiring all capital market operators to ensure that the rating of bonds be filed with the Commission before application. SEC expects this new measure to enhance proper assessment of bonds as well as investors' confidence in the bond market.[41]

Issuing Houses. The registration requirements for issuing houses are governed by rule 29, part A4, of the Securities and Exchange Commission Rules and Regulations.

An application for registration is to be made to the Securities and Exchange Commission with the requisite Form SEC 3, accompanied by the following documents:

- A minimum of three sets of the duly completed Form SEC 2 to be filed by the sponsored individuals;[42]
- A copy of the certificate of incorporation certified by the Corporate Affairs Commission, Abuja;[43]
- A certified true copy of the memorandum and articles of association of the company;[44]
- A copy of the particulars of directors of the company (CAC Form C07), certified as a true copy by the Corporate Affairs Commission;
- A copy of the latest audited accounts, or an audited statement of affairs for companies in operation for less than one year;
- The company profile;
- A fidelity bond representing 25 per cent of the paid-up capital of the company;
- A sworn undertaking to keep proper records and render returns;
- Evidence of minimum paid-up capital of N 150 million.[45]

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40 Investments and Securities Act, 1999, s 29(3), stipulates that any institutional foreign investor also must obtain this certificate before dealing in securities.

41 Securities and Exchange Commission, Press Release of 28 February 2003.

42 'Sponsored individuals' are the principal officers and/or professionals held out by the applicant company as experts on whose advice or actions investors are expected to rely. These individuals are required to be registered by the Securities and Exchange Commission and are required to possess some minimum level of qualification; Securities and Exchange Commission Rules and Regulations, rule 15, part A1.

43 Where an uncertified copy is filed, the applicant is required to present the original for sighting by an authorised officer of the Securities and Exchange Commission.

44 The objects of the memorandum should confer on the company the powers to act as an issuing house.

45 Rule 17, Part A2, of the Securities and Exchange Commission Rules and Regulations requires the following documents to be filed with the Securities and Exchange Commission as evidence of compliance with the paid-up capital requirement: (a) a copy of the Board Resolution authorising the increase in share capital certified by the Corporate Affairs Commission, (b) evidence of registration of such increase with the Corporate Affairs Commission, certified by the Corporate Affairs Commission, (c) audited statement of account or management account signed by two directors with a letter of confirmation by an external auditor or a statement of affairs signed by an auditor, showing that the increase has been paid-up, and (d) where capital contributed is in the form of real property, title documents in the name of the company in respect of the capitalised properties.

The head of the issuing house must have practical experience in packaging public issues. The issuing houses are required to file applications for renewal of their registration every two years.[46] The application for renewal of the registration should be filed at least 30 days prior to the date of expiration supported by evidence of attendance of at least one course organised by training bodies recognised by the Securities and Exchange Commission.

All registered issuers, brokers, and dealers are required to display the Certificate of Registration issued by the Securities and Exchange Commission at the reception of their offices. In addition, they are required to comply with the Securities and Exchange Commission rules on orderly, fair, and equitable dealings in securities and to ensure that they maintain proper standards of professionalism in securities business. They also must comply with the Code of Conduct for capital market operators, as approved by the Securities and Exchange Commission.

Such bodies would include the Nigerian Stock Exchange, Chartered Institute of Brokers, and/or any other organisation as may be approved by the Securities and Exchange Commission.[47]

Every corporate body registered in accordance with the Securities and Exchange Commission regulations is required to provide and maintain a bond, which should be issued by an insurance company acceptable to the Securities and Exchange Commission against theft, stealing, fraud, or dishonesty, covering each officer, employee, and sponsored individuals of the company.

Registered persons and bodies are to keep and maintain all books, records, and financial reports, required under the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations, in a readily accessible place, for not less than five years from the end of the year during which the last entry was made on such record, and during the first two years of this period in an appropriate office of the registered person. Registered issuing houses also are required to:

- Maintain the prescribed minimum paid-up capital and to have, at all times, sufficient liquid assets to cover their current indebtedness;
- Act as agents of issues for purposes of primary issues, co-ordinate activities of other professionals and parties to the issue, and prepare the registration statement, the prospectus, and other offer documents,[48] and fulfil any other roles ancillary to these; and
- Make the following returns to the Securities and Exchange Commission (a) allotment proposal, (b) statement of account as at the date of allotment, (c) evidence of transfer of the proceeds of the issue to the issuer, (d) certified copies of returns filed with the Corporate Affairs Commission, (e) semi-annual statement of activities in the capital market including staff movement, (f) completed Form QR/3 of the Securities and

46 Securities and Exchange Commission Rules and Regulations, rule 19, part A2.
47 Securities and Exchange Commission Rules and Regulations 1999, rule 19A(3)(g), as amended.
48 Securities and Exchange Commission Rules and Regulations, as amended, rule 183, part E5.

Exchange Commission, and (g) evidence of publication of results of allotment in at least two national newspapers.[49]

Issuing Houses are permitted to act as Receiving Bankers in the same issue subject to meeting the qualifying requirements set out under the Securities and Exchange Commission Rules and Regulations.[50]

Foreign Capital Market Operators. The Companies and Allied Matters Act stipulates[51] that every foreign company which, having been incorporated outside Nigeria, desires to carry on business in Nigeria, must be incorporated in Nigeria, as a separate entity for that purpose and, until so incorporated, cannot carry on business in Nigeria or exercise any of the powers of a registered company.

Foreign capital market operators are required to register with the Securities and Exchange Commission before they can establish a securities business in Nigeria.[52] However, before registering with the Securities and Exchange Commission, they must be incorporated in Nigeria. Other than the certificate of local incorporation, the other documents to be presented are:

- Proof of registration from the Securities Commission or the relevant regulatory authority in its country of domicile;
- Latest audited accounts of the foreign capital market operator in its country of domicile;
- Management and promoter's profile;
- Certified true copy of the foreign capital market operator's memorandum and articles of association or its equivalent;
- Certified true copy of the Certificate of Incorporation in the country of domicile; and
- Any other information considered by the Securities and Exchange Commission to be relevant.

If the foreign capital market operator intends to partner with an existing Nigerian registered capital market operator or acquires part of a Nigerian business, the registered capital market operator may sponsor the foreign capital market operator for registration with the Securities and Exchange Commission by filing the application forms accompanied by the required documents.

Foreign Issuers. A foreign issuer, ie, a foreign government or a company incorporated or organised in a foreign country, may utilise the service of the Nigerian capital market in

49 Securities and Exchange Commission Rules and Regulations, as amended, rule 185, part E5.
50 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 184(1), part E5.
51 Companies and Allied Matters Act, s 54.
52 Securities and Exchange Commission Rules and Regulations, rule 211, part F.

issuing, selling, or offering for sale or subscription securities to the Nigerian public. These securities may be denominated in Naira or in any convertible foreign currency.

Foreign issuers of securities are required to file an application for registration of their securities with the Securities and Exchange Commission accompanied by a draft prospectus under such conditions as prescribed by the Securities and Exchange Commission. The application is to be filed using the Securities and Exchange Commission Form 6F, and it is to be accompanied by a registration fee, which is prescribed by the Securities and Exchange Commission from time to time.

However, where it is in the 'public interest' and where a reciprocal agreement exists between Nigeria and the country of the issuer, or the issuer's country is a member of the International Organisation of Securities Commissions, the Securities and Exchange Commission may grant exemption from compliance with any of the requirements for registration to securities issued in that country. These exemptions may include the waiving of a full compliance under the Securities and Exchange Commission regulations by the acceptance of a prospectus approved or cleared by a foreign Securities Commission and the adoption of audited annual reports/accounts of foreign issuers accepted by the Securities Commission of that country. This, however, does not relieve an issuer from the requirements of filing reports, forms, or other documents related to the securities as may be prescribed by the Securities and Exchange Commission.

Effectiveness and Renewal of Registration. The Securities and Exchange Commission is required to notify an applicant for registration (or renewal) of its decision granting or renewing the registration. Until receipt of the formal notification, the registration or renewal shall not take any effect.[53]

In addition, all applicants can apply to the Securities and Exchange Commission for an extension of time within which it is required to make known its decision to grant or deny an applicant's request.[54] The rationale may be to afford an applicant the opportunity to resolve queries or put in further documentation the absence of which could have resulted in an adverse decision. This rule previously applied only to the registration of Securities Exchanges.

Withdrawal of Registration. Capital market operators seeking withdrawal from their registered functions are required to file, among other requirements, a list of all their clients with outstanding liabilities written against their names and evidence of discharge of all outstanding obligations to the Securities and Exchange Commission.[55]

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53 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 19B, part A2.

54 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 22(3) and (4), part A2.

55 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 20(5), part A2.

The suspension or withdrawal of a market operator effectively suspends or withdraws the registration of the sponsored officers. A sponsoring officer who resigns his employment with the sponsoring company is required to obtain a fresh registration with the Securities and Exchange Commission in his new employment.[56] The market operator is obliged to notify the Securities and Exchange Commission of the resignation or dismissal of any of its employees where such dismissal was based on fraudulent or manipulative acts in connection with activities in the capital market.

Reinstatement of Suspended Registration. A suspended capital market operator can apply for revalidation or reinstatement of its registration where it is able to provide evidence that it has complied with the terms and conditions of the suspension order issued by the Securities and Exchange Commission.[57]

However, where the suspended capital market operator is unable or failed to comply with the terms and conditions of the suspension order within 12 months, its registration will be void. The capital market operator will be obliged to make a fresh application. If the capital market operator fulfils the stipulated requirements for reinstatement, then the Securities and Exchange Commission is obliged to effect such reinstatement within 14 days.[58]

Securities Requirements. All securities must be registered by the Securities and Exchange Commission before they can be issued, sold, transferred, or offered for subscription or for sale to the public, and prior approval for the issue, sale, transfer, or public offer must have been granted by the Securities and Exchange Commission.[59] Securities registered by the Securities and Exchange Commission may be transferred electronically or by any other means or system approved by the Securities and Exchange Commission, under such terms and conditions as the Securities and Exchange Commission may prescribe, to a securities exchange or capital trade points or any other self-regulatory organisation.

All issuers of securities are required by the Investments and Securities Act to keep a register of securities into which all the information and particulars of the securities are entered. Securities dealers also are required to keep accounting and other records to sufficiently explain the transactions and financial position of their business and enable true and fair profit and loss accounts and balance sheets to be prepared from time to time. The following bodies are required to register their securities with the Securities and Exchange Commission:

- Public quoted companies;
- Public unquoted companies;

56 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 21(4), part A2.
57 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 21(6), part A2.
58 Securities and Exchange Commission Rules and Regulations 1999, as amended, rule 21(7), part A2.
59 Investments and Securities Act, 1999, s 32; Companies and Allied Matters Act, 1990, s 547.

- Governments and government agencies; and
- Investment schemes.[60]

The types of securities to be registered are as follows:

- Issued securities, ie, ordinary shares, bonus shares, debentures, preference shares, rights issue and units of a unit/investment trust scheme, and asset-backed securities;
- Issue of securities for the purpose of taking over an existing business or asset;
- Securities offered to the public;
- State and local government bonds and securities; and
- Investment contracts or participation in any profit-sharing agreement or in any oil or gas or other mineral royalties or lease.[61]

Any securities offered through the following media also are subject to registration by the Securities and Exchange Commission:

- Offer for subscription;
- Offer for sale;
- Rights issue;
- Bonus issue;
- Private placement by public companies;
- Securities arising from conversion of a company to a public limited company;
- Debenture loan stock;
- State and local government bonds; and
- Offer by introduction.[62]

However, the Securities and Exchange Commission may exempt any securities from being registered if such exemption is in the interest of the public and does not endanger investor interest. The Securities and Exchange Commission also has the power to prohibit trading in particular securities that have been offered at a securities exchange or capital trade point in the interest of the public, although it must first issue a notice to that exchange or capital trade point.[63]

Before securities can be registered, the issuer must file an application on Form SEC6 accompanied by the following documents:

- A copy of the resolutions passed in the general meeting of the company authorising the offer and certified by the company secretary;
- Two copies of the memorandum and articles of association of the issuer company with any amendments thereto, certified by the Corporate Affairs Commission;

60 Securities and Exchange Commission Rules and Regulations, rule 106, part C1.
61 Securities and Exchange Commission Rules and Regulations, rule 107, part C1.
62 Securities and Exchange Commission Rules and Regulations, rule 40, part A5.
63 Investments and Securities Act, 1999, s 27(1).

- A copy of the certificate of incorporation certified by the company secretary;[64]
- A signed copy of each audited account for the preceding five years or number of years for which the company has been in operation, if less than five years;
- Two copies each of the draft prospectus and the abridged prospectus;
- Two copies of the draft trust deed, where applicable;
- Two copies each of the draft underwriting agreement and sub-underwriting agreement, where applicable;
- Vending agreement;
- Where there are more than one issuing house, the agreement regulating the relationship between the joint issuing houses;
- Letters of consent given by the parties to the issue, sworn before a notary public;[65] and
- Any other document required by the Securities and Exchange Commission.[66]

In addition, the application to the Securities and Exchange Commission should contain information indicating the type and character of the securities and the following:

- The nominal value, the rate of dividends if fixed, and whether they are cumulative or non-cumulative;
- A brief description of the preference shares, if any;
- In the case of debt instruments, the rate of interest, the date of maturity or, if the issue matures severally, a brief description of the serial maturities;
- If the payment of principal or interest is contingent, an appropriate indication of such contingency, a brief indication of the priority of the issue and, if convertible, a statement to that effect;
- The organisational and financial structure and the nature of business of the company, including any risk factors;
- The directors, officers, and underwriters, if any, and each securities holder of record holding more than five per cent of any class of any equity or N 50,000 in value, whichever is higher;
- The bonus and profit-sharing arrangement;
- The management and service contracts;
- The write-up from the issuing house on the issue;
- A schedule of claims and litigation;
- The bridging loan agreement and schedule of other material contracts, where applicable;
- Evidence of property ownership or transfer; and
- Any other document or information required by the Securities and Exchange Commission.

64 Where a copy is not certified, the original should be presented for sighting by an authorised officer of the Securities and Exchange Commission.
65 Where the consent is contained in a power of attorney, it must be executed and stamped.
66 Securities and Exchange Commission Rules and Regulations, rule 40(B), part A5.

If the securities are for listing on an exchange, or with any association or body of securities dealers recognised by the Securities and Exchange Commission, the issuer also must file with the Securities and Exchange Commission copies of the duplicates and originals of the application to the exchange and a certificate to the effect that the application has been made. The directors of the issuer and other parties to a public offer will sign copies of the approved prospectus and other documents of offer which the issuer must forward to the Securities and Exchange Commission within 48 hours of the signing of the prospectus.

The documents may, in the absence of the issuer, be signed by an authorised representative with a duly stamped power of attorney. If the securities registered by the Securities and Exchange Commission are not offered to the public within six months after registration, the issuer must obtain a revalidation of the issue from the Securities and Exchange Commission before the offer to the public. An issuer may list its securities on one or more exchanges provided it complies with the listing requirements of the relevant exchange.

Prospectus Requirement. Any form of application for securities in a public company must be issued with a prospectus.[67] However, if the form of application was issued either in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares, or in relation to shares which were not offered to the public, then this requirement will not apply.[68] The requirement also will not apply to the following situations:

- Issue to existing members of a company of a prospectus or form of application relating to shares in the company whether or not an applicant for shares has the right to renounce in favour of other persons; or
- Issue of a prospectus or form of application relating to securities, which are or are to be in all respects uniform with all securities previously issued and for the time being dealt in, or quoted on, a recognised stock exchange or capital trade points.[69]

An applicant may apply for a certificate of exemption where, having regard to the proposal (ie, the size and other circumstances of the issue of securities) and the limitations on the number and class of persons to whom the offer is to be made, compliance with the requirements of a prospectus would be unduly burdensome. This exemption may be granted even though the offer consists of securities from a public company to persons who are not existing members of the company. Nevertheless, an application has been made to a recognised Stock Exchange for permission to deal in or quote the securities on that Exchange.[70]

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67 Rule 53(I) requires the prospectus to be in duplicate and no longer in size than A4 paper and printed forms. For issuers of securities through the Capital Trade point, the prospectus may be abridged in terms of content and may be in printed form.

68 Investments and Securities Act, 1999, s 48.

69 Investments and Securities Act, 1999, s 51.

70 Investments and Securities Act, 1999, s 53.

Where a prospectus includes an expert[71] statement, it cannot be issued unless the expert has given his written consent to the issue and a statement that the expert has given and has not withdrawn his consent appears in the prospectus.[72]

Any prospectus issued by, or on behalf of, a company or in relation to an intended company must be dated and, unless the contrary is proved, that date will be regarded as the date of publication of the prospectus.[73] In addition, no prospectus can be issued unless, on or before the date of its publication, a copy has been delivered to the Securities and Exchange Commission for registration and signed by every person who is named in it as a director or a proposed director of the company or by his agent authorised in writing.[74] Every prospectus should:

- State that a copy has been delivered to the Securities and Exchange Commission for registration; and
- Refer to statements included in the prospectus which specify any documents required to be endorsed on or attached to the copy so delivered.[75]

The Securities and Exchange Commission will not register a prospectus unless it is satisfied that it is dated and signed as required and that all required documents have been endorsed on it or attached to it and the prospectus complies with all the other requirements of the law.

The required contents of a prospectus are specified in part I of the Third Schedule to the Investments and Securities Act, 1999. A prospectus also must set out the reports specified in part II of the Schedule. A statement in lieu of a prospectus must be in the form and contain the particulars set out in part I of the Fourth Schedule to the Investments and Securities Act. The Securities and Exchange Commission Rules and Regulations reinforce the provisions of the Investments and Securities Act on the requirements of a prospectus and further provide additional specifications with regard to details about the form, size, number, statements, and contents in rules 53–58 of part B1.

The Securities and Exchange Commission has proposed additional disclosure requirements for the primary and secondary markets relating to, amongst others, caveat on risk factor on the cover page of the prospectus, corporate director, conflicts of interest, mergers or takeover, and the Accountant's Report.[76]

Allotment of Shares and Under-Subscription. An application to the Securities and Exchange Commission for clearance of any allotment proposal must be accompanied by

71 An expert is defined as including an engineer, legal practitioner, accountant, and any other person whose profession gives authority to a statement made by him.
72 Investments and Securities Act, 1999, s 54.
73 Investments and Securities Act, 1999, s 49.
74 Investments and Securities Act, 1999, s 57.
75 Investments and Securities Act, 1999, s 57.
76 Securities and Exchange Commission — 'Proposed Additional Disclosure Requirements for the Primary and Secondary Markets' published in *Thisday Newspaper*, of 16 June 2003.

a joint letter of consent signed by the issuer and the issuing house and forwarded by the issuing house with other documents.

The requirement that undersubscribed and underwritten securities should be warehoused by the issuing house or underwriters have been extended to securities listed on the capital trade point. In the case of such securities, the issuer or issuing house is required to warehouse and underwrite the securities where there is under-subscription and, thereafter, sell the securities on the floors of the Securities Exchange or capital trade point within six months after allotment.

The minimum subscription level for securities listed on the Capital Trade Point is 50 per cent, while that of companies listed on other Stock Exchange remains 25 per cent. However, where an issue not underwritten is undersubscribed (ie, less than 25 per cent subscription level and 50 per cent in the case of securities offered through the Capital Trade Point), the issue must be aborted by the issuer and issuing house.

Corporate Governance. The management and administration of companies in Nigeria is regulated by the Companies and Allied Matters Act and by the articles of association of the companies, which must comply with the general provisions of the Companies and Allied Matters Act. The Corporate Affairs Commission is the regulatory authority vested with the power to administer the Companies and Allied Matters Act and to regulate and supervise the affairs of companies, especially where the interests of shareholders and the public so demand. The provisions of the Companies and Allied Matters Act regulating the acts of directors, for instance, include:

- The duty of directors to disclose age;[77]
- The prohibition of insolvent persons from acting as directors;[78]
- The restraint of fraudulent persons;[79]
- The disqualification for directorship;[80]
- The removal of directors;[81]

77 Sections 252 and 256 of the Companies and Allied Matters Act provide that any person above the age of 70 who is appointed as a director of a public company must disclose this fact to the members of the company at a general meeting.

78 Section 253 of the Companies and Allied Matters Act prohibits all insolvent or bankrupt persons from acting as directors of any company and/or taking part (directly or indirectly) in the management of the company.

79 Section 254 of the Companies and Allied Matters Act precludes any person who is guilty of an offence in connection with the formation or management or winding up of a company from being appointed as a director for a specified period not exceeding 10 years.

80 Sections 257 and 278 of the Companies and Allied Matters Act disqualify the following persons from acting as directors of a company: an infant (ie, a person under the age of 18 years), a lunatic or a person of unsound mind, a person disqualified on grounds of insolvency or bankruptcy and being guilty of fraud, a person who resigns his office by notice in writing to the company, and a corporation other than its representative appointed to the board of directors for a given term.

81 Section 262 of the Companies and Allied Matters Act provides that a company may by ordinary resolution remove a director, notwithstanding anything in its articles of association or in any agreement between them, provided that a special notice is given to the affected director of such resolution.

- The remunerations of directors;[82]
- The prohibition of loans and guarantees to company directors;[83]
- The disclosure of a director's interest;[84]
- The disclosure of a director's particulars;[85]
- The roles of directors and their fiduciary relationship;[86]
- The conflict of duties and interests;[87]
- The duty of directors to exercise a duty of care and skill;[88] and
- A director's legal position.[89]

To ensure transparency, the provision of adequate information to the public, and general access to corporate documentation, the Companies and Allied Matters Act mandates all companies to keep proper records. All companies must keep a register of member/shareholders, a register of directors and secretaries, and a register of share transfers. In addition, proper accounting records must be kept. Section 331 of the Companies and Allied Matters Act provides that these records must be sufficient to show and explain the transactions of the company and disclose, with reasonable accuracy, the financial position of the company at any point in time. The accounting records are to be kept either at the registered address of the company or wherever the directors think fit and should be open to inspection by the officers of the company at all times. The records are to be preserved for a period of six years from the date on which they were made.

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82 Section 267 of the Companies and Allied Matters Act provides that the remuneration of directors is to be determined from time to time by the company in general meeting. A director who receives more than he is entitled to would be guilty of a misfeasance and accountable to the company for such money.

83 Section 270 of the Companies and Allied Matters Act precludes companies from giving loans or guarantees or securities with respect to any loan to its director or a director of its holding company except in special circumstances, such as when the fund is required to meet the obligations of the company.

84 Section 275 of the Companies and Allied Matters Act requires every company to maintain a register showing the number, description, and amount of shares or debentures held by any director of the company. It is the duty of any director who holds such shares to disclose this to the company. In addition, section 277 provides that every director has a duty to disclose any interest in a contract or proposed contract with the company.

85 Section 278 provides that every company should state the names and nationalities of every Nigerian director on its letterhead, trade catalogues, trade circulars, and show cards.

86 Section 279 of the Companies and Allied Matters Act stipulates that all directors stand in a fiduciary relationship towards the company and should observe the utmost good faith in any transaction with the company or on its behalf.

87 Section 280 states that the personal interest of a director should not conflict with any of his duties as a director and, in the course of his management of the affairs of the company or in the utilisation of the company's property, he should not make any secret profit or achieve other unnecessary benefits.

88 Section 282 provides that all directors are to discharge their duties honestly, in good faith, and in the best interests of the company. They must exercise the degree of care and skill which a reasonably prudent director would exercise in comparable circumstances.

89 Section 283 provides that directors are trustees of the company's money, properties, and powers. In this regard, they must account for all the money over which they have control and refund any money improperly paid away. They also must exercise their powers honestly in the interest of the company and its shareholders.

Furthermore, the directors have a duty to prepare the financial statements of the company every year, as stipulated in section 335 of the Companies and Allied Matters Act. The financial statement must comply with the Companies and Allied Matters Act and the standards laid down in the Statements of Accounting Standards issued by the Nigerian Accounting Standards Board. The balance sheet and the profit and loss account must give a true and fair view of the company for each year.

According to section 344, every member of the company and holder of the company's debentures must be given a copy of the financial statement. Section 345 provides that the directors of the company must lay the financial statement before the members of the company at the annual general meeting every year. The report of the auditors on the financial statements also is to be read at the annual general meeting and should be open to inspection by any member of the company. Subsequently, the financial statements must be filed together with the Annual Returns of the company at the Corporate Affairs Commission.

Section 370 of the Companies and Allied Matters Act stipulates that all companies limited by shares or guarantee should file the company annual returns, which contains relevant information about the company in the past year, at the Corporate Affairs Commission every year. All companies also are mandated to update their corporate information at the Corporate Affairs Commission and to report any changes, eg, changes in the composition of the board of directors or other officials of the company, allotment of new shares, and change in registered address of the company. The corporate records of all companies at the Corporate Affairs Commission are open to examination by the general public.

The Companies and Allied Matters Act also provides, in section 357, for the appointment of auditors at the annual general meeting of the company to audit the financial statements of the company and to hold office until the next annual general meeting. The auditors have a duty, as stipulated in section 360, to carry out investigations on the company to enable them to form an opinion as to whether the company has kept accounting records and whether the balance sheet and the profit and loss statement are in agreement with the accounting records.

The Securities and Exchange Commission has 'midwifed' a Code of Best Practices for Public Companies in Nigeria (the 'Code'). The Code is derived from the report of a Committee set up by the Securities and Exchange Commission and makes recommendations focused on the transparency and accountability of the management and boards of companies. The Code encourages voluntary compliance with the Committee recommending that all public companies comply with the Code and be required to state reasons for non-compliance.

Registration of Public Offerings. Rule 51, part B1, of the Securities and Exchange Commission Rules and Regulations require the issuer or issuing house to file a registration statement with the Securities and Exchange Commission before any public offering of securities is made. In addition, the issuer must comply with the provisions of the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations on the registration of securities discussed above. After the registration

statement has been filed, it will be cleared by the Securities and Exchange Commission, and a Completion Board Meeting will be held before the issue is authorised to open.

It is unlawful for any person to buy or sell securities before this procedure is completed except in the following circumstances:

- Preliminary negotiations or actual agreement between the issuer and the underwriter;
- Oral offers not made to the public; and
- Notices of proposed offerings.

Registration of Placements. Rule 96, part B3, of the Securities and Exchange Commission Rules and Regulations provides that, where a private offering of registered securities is proposed, the issuer should file two copies of the placement memorandum with the Securities and Exchange Commission. The placement memorandum and accompanying documents should not contain any false or misleading information. The issuer also is required to file a report with the Securities and Exchange Commission not later than 10 days after the first sale of the securities. The report, which should be signed by persons duly authorised by the issuer, must contain the following information:

- Names and addresses of the parties to the offer;
- Basic information about the issuer;
- Information about the offering, such as offer price, volume of securities, and number of investors;
- Name and addresses of the purchasers;
- Amount purchased and the mode of payment;
- Time of payment;
- Nature of the purchaser; and
- Amount the company is raising.[90]

All private offerings must meet the criteria and requirements for securities as prescribed by the Securities and Exchange Commission Rules and Regulations. No issuer is allowed to make more than one private offering a year, and issuers are not allowed to offer for subscription or sell securities by way of private placement without obtaining prior written approval from the Securities and Exchange Commission.[91]

Private offerings may not be offered by any form of public invitation, general solicitation, or general advertising, including seminars or meetings to which those attending have been invited by any general solicitation or general invitation.[92] In addition, there should be no more than 50 purchasers of the securities offered.

90 Securities and Exchange Commission Rules and Regulations 1999, rule 96(3), part B3, as amended.
91 Securities and Exchange Commission Rules and Regulations, rule 90, part B3 (as amended).
92 Securities and Exchange Commission Rules and Regulations, rule 91, part B3 (as amended).

Extension of Offer Period. The Securities and Exchange Commission may on application by the issuer extend the offer period if it can be shown that there has occurred within the offer period:

- An upheaval, whether religious, political, or social (occurring nationwide or within the catchment areas of the issuer, ie, where most of the shareholders reside);
- A crisis such as labour unrest or riots which could lead to office shutdowns,
- A minimum of three days' public holidays; or
- Natural disasters, such as an earthquake or fire.[93]

Registration of Secondary Trade. Secondary trading in listed securities does not require any registration with the Securities and Exchange Commission or Nigerian Stock Exchange. However, the Registrar of the listed company whose securities are being traded must record the transaction and enter the name of the new owner in the Register of members. To complete the transfer of the securities on the floor of the Stock Exchange, the stock broker involved in each transaction has the duty to:

- Forward the certificate of the transferor to the Company's Registrar for rectification; and
- Inform the Central Securities Clearing System of the transfer.[94]

Periodic Disclosure

General Reporting Obligations of Listed Companies

In General. Public companies that are listed on the Nigerian Stock Exchange owe disclosure obligations to the Nigerian Stock Exchange, as well as to the following bodies:

- The Corporate Affairs Commission; and
- The Securities Exchange Commission.

Corporate Affairs Commission. All companies registered in Nigeria are required to make the following returns (statutory returns) at the Corporate Affairs Commission:

- Change of company name (within 15 days of passing the resolution authorising the change);
- Amendment of objects clause in the memorandum of association or amendment of the articles of association (within 15 days of resolution);[95]
- Allotment of shares (within one month of allotment);
- Increase or reduction in authorised share capital (within 15 days of resolution);[96]

93 The minimum aggregate offer value of N 25 million is no longer required. Issuers are free to offer for sale or subscription by way of private placement securities whether or not their aggregate value is up to N 25 million.

94 The Central Securities Clearing System will demobilise the securities and record the transfer.

95 This period is counted from the end of the 28-day period allowed for dissenting members to apply to court for the cancellation of the resolution.

96 In the case of reduction, the company is further required to register with the Corporate Affairs Commission the court order sanctioning the reduction.

- Conversion and division of stocks and shares (within one month of event);
- Creation of charges by the company or acquisition of property which is subject to a charge (within 90 days of creation of charge or acquisition of property);
- Change in registered address of the company (within 14 days of change);
- Appointment, removal, or resignation of a director (within 14 days of resolution);
- Appointment, removal, or resignation of the auditor (within 14 days of appointment, removal, or deposit of notice of resignation);
- Appointment or change of company secretary (within 14 days of appointment or change);
- Relocation of register of members (within 28 days of relocation);
- Variation of class rights (within 15 days of resolution);[97] and
- Passing of a special resolution, ie, a resolution approved by at least a three-quarters majority of the members of the company present and voting at a meeting of the members of the company (within 15 days of resolution).

Annual returns also must be filed within 42 days of the annual general meeting of a company.[98] The annual returns disclose matters such as the company's registered office, shareholding structure, directors, and company secretary.

Default in filing the required statutory return within the stipulated time results in a liability on the company and its affected officers to pay a stipulated amount, as a fine, to the Corporate Affairs Commission, calculated per each day of default. In practice, the Corporate Affairs Commission may impose a fixed amount on the company as a late filing fee. Default in registering any charge created by the company makes such charge void as against the company's liquidator in the event of a subsequent winding-up of the company. Failure to file the annual returns also may result in the Corporate Affairs Commission striking off a company's name from the Register of Companies.

Generally, to ensure smooth conduct of its business in Nigeria, every company must consistently update its corporate data at the Corporate Affairs Commission as this impacts other matters, such as registration and compliance requirements of other regulatory bodies (eg, the Nigerian Stock Exchange and the Securities and Exchange Commission), contract bids, and foreign exchange remittance.

Securities and Exchange Commission. All public listed companies are required to register their securities with the Securities and Exchange Commission.[99] Thereafter, such

97 Where an application is made by dissenting shareholders for cancellation of the variation, a copy of the court order made pursuant to the application must be submitted to the Corporate Affairs Commission within 15 days of the date of the order.

98 Companies and Allied Matters Act, ss 370 and 374. This should be filed together with the company's audited accounts for the year.

99 The Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations primarily impose reporting obligations on capital market operators. Rule 9 of the Securities and Exchange Commission Rules and Regulations, however, empowers the Securities and Exchange Commission to examine the records and affairs of, or call for information from, any company covered by the provisions of the Investments and Securities Act.

companies are required to file certain reports with the Securities and Exchange Commission,[100] and these would include reports on beneficial owners of five per cent or more of the company's shares, and transactions involving such persons.[101]

In addition, on obtaining Securities and Exchange Commission approval to the acquisition of its own shares, a company is required to make quarterly returns to the Securities and Exchange Commission with respect to the acquisition or any subsequent disposal of such shares. The returns must disclose particulars of any nominee or trustee holding those shares on behalf of the company.[102]

The Securities and Exchange Commission requires each listed company to submit six copies of its quarterly, half-yearly, and annual reports, respectively. The quarterly and half-yearly reports are to be made available to the Securities and Exchange Commission at the same time as they are submitted to the Nigerian Stock Exchange. The annual report is required to be despatched simultaneously to the shareholders, the Nigerian Stock Exchange, and the Securities and Exchange Commission.

The Registrar of a listed company is required to publish once a year, in at least two national daily newspapers, the details of shareholders who are yet to claim their share certificates and, thereafter, file documentary evidence of compliance with this requirement with the Securities and Exchange Commission.[103] The Registrar also is required to submit a statement of all unclaimed dividends and interest warrant to the Securities and Exchange Commission.[104]

Furthermore, a listed company intending to offer securities to the public must first submit a copy of the prospectus or other offer document to the Securities and Exchange Commission,[105] which will review such document to ensure that it makes full disclosure relating to the affairs of the company and the securities being offered, in compliance with the provisions of the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations relating to the contents of a prospectus.

Nigerian Stock Exchange. Each listed company is required to provide the Nigerian Stock Exchange and the investing public with material information about its activities at the time of seeking listing and, once its shares are admitted to the official list, it must comply with the post-listing requirements of the Nigerian Stock Exchange to retain

100 Securities and Exchange Commission Rules and Regulations, rule 106. Under rule 108, however, the Securities and Exchange Commission may exempt any securities from being registered and any company from reporting if it considers such exemption to be in the interest of the public, and it does not endanger investors' interests.

101 Securities and Exchange Commission Rules and Regulations, rule 109(A).

102 Securities and Exchange Commission Rules and Regulations, rule 109(B).

103 Securities and Exchange Commission Rules and Regulations, rule 200. With the introduction of the Central Securities Clearing System, share certificates have become irrelevant in transactions on the Nigerian Stock Exchange.

104 Securities and Exchange Commission Rules and Regulations, rule 204(5), part E9, as amended.

105 Submission must be within six months prior to the making of the invitation.

listing. The post-listing requirements mainly consist of continuous disclosure obligations to the Nigerian Stock Exchange and the investing public.

The Rules Governing Listing on the Nigerian Stock Exchange ('the Listing Requirements') provide that, before the grant of listing, all applicant companies must sign a General Undertaking that they will promptly provide certain information about their operations.[106]

Financial Statements and Reports

The dictates of the general undertaking require a company whose shares are listed on the Nigerian Stock Exchange to make both interim and final reports to the Nigerian Stock Exchange.[107]

Interim reports consist of quarterly statements and forecasts (whether or not audited), which must be submitted to the Nigerian Stock Exchange not later than six weeks after the end of each quarter of the year.[108] Companies listed on the First-Tier Market are to make quarterly and half-yearly returns, while companies listed on the Second-Tier Market are required to make only semi-annual returns. The Listing Requirements also provide that interim reports and accounts approved by the directors should be despatched to all shareholders not later than six months from the date of the notice convening the last annual general meeting of the company.[109] However, the Nigerian Stock Exchange will accept publication of the reports and accounts in at least two leading national daily newspapers as sufficient for this purpose.[110]

The final report consists of the annual report and audited accounts approved by the Board of Directors of a listed company, which must be submitted to the Nigerian Stock Exchange at least 21 days prior to the company's annual general meeting.[111] Where applicable, consolidated accounts of a group of companies must be submitted. The following must be included in, or circulated with, the annual report and audited accounts:

- Description of the operations carried on by the company or, where the company has subsidiaries, the group;
- Where the company has subsidiaries or associated companies, information on the name and country of operation of each subsidiary or associated company and the nature and quantum of interest of the company in each subsidiary or associated company;
- Particulars of any arrangement for the waiver of directors' emoluments;

106 Rules Governing Listing on the Nigerian Stock Exchange, item (d), General Requirements.
107 The Listing Requirements are under review, and certain changes may be made with regard to the timing for the submission of financial statements and reports to the Nigerian Stock Exchange.
108 Rules Governing Listing on the Nigerian Stock Exchange, item 6(b), appendix III.
109 Rules Governing Listing on the Nigerian Stock Exchange, item 6(a), appendix III.
110 It is generally not compulsory for companies listed on the First-Tier Market to publish their reports for the first quarter and the third quarter.
111 Rules Governing Listing on the Nigerian Stock Exchange, item 4(a), appendix III.

- Statement detailing the particulars of directors' shareholding as at the end of the financial year, which should reflect changes in such shareholding between the end of the financial year end and a date not more than one month prior to the notice convening the annual general meeting; and
- Statement detailing the particulars of persons other than directors holding more than five per cent[112] of the shares of the company as at a date not more than one month prior to the notice convening the annual general meeting.[113]

In addition, the following minimum information[114] must be disclosed in the annual report:

- Turnover figures representing sales exclusively to third parties;
- Other income, such as investment income, rents, profits from sale of assets, and other unusual items (listed separately);
- Profit before tax;
- Tax payable and paid;
- Profit after tax;
- Sources and application of funds;
- Value-added statements;
- Sales and profit contribution per activity;
- Interest expenses and similar charges;
- Dividend proposed and dividend liability with full disclosure;
- Five-year financial summary;
- Directors' direct and indirect holdings in the issued shares;
- Substantial shareholdings representing five per cent or more of the issued shares; and
- Capital expenditure.

Every listed company also is required to deliver to the Nigerian Stock Exchange for vetting and approval, not less than 14 days before despatch, two copies of proof of all circulars and notices to shareholders together with accompanying documents, quarterly reports and forecasts, and bi-annual and annual reports and accounts.[115] The Nigerian Stock Exchange makes these documents available to the stockbrokers on the trading floor of the Exchange to enable them to react to the interim and final performances of listed companies. Nigerian Stock Exchange approval must, thereafter, be given before all such documents, including the reports and accounts, can be published.

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112 Although the rules governing listing prescribe five per cent, in practice, the Nigerian Stock Exchange would require such a statement where the shareholding is more than 10 per cent.
113 Rules Governing Listing on the Nigerian Stock Exchange, item 3(a), appendix III.
114 Rules Governing Listing on the Nigerian Stock Exchange, item 6(a), appendix III.
115 Rules Governing Listing on the Nigerian Stock Exchange, item 2, appendix III.

Other Disclosure Obligations

Every listed company must promptly notify the Nigerian Stock Exchange of certain facts, which could in any way affect the market value of its shares. These include the following:

- Announcement of dividends, changes in capital structure, redemption of securities, or any other activity or incident that could affect the market price of the company's shares;
- Changes in the board of directors;
- Proposed alteration of the memorandum or articles of association of the company, in the general character or nature of the business of the company (or the group), or in voting control or in beneficial ownership of the securities carrying voting control;
- Decision of the company (or its subsidiaries) to acquire controlling shares in another company or to acquire another business or a share of another business;
- Extension of time granted for the currency of temporary documents;
- Date and time the Board of Directors is expected to meet to discuss dividends, which must be at least 14 days in advance; and
- Other information necessary to enable shareholders to appraise the position of the company and to avoid the establishment of a false market in respect of the company's shares.[116]

Where the securities involved are debentures or bonds, there are currently no disclosure obligations to the Nigerian Stock Exchange. It is the duty of the Trustee to the issue or bond to ensure compliance with the terms and conditions of the debenture or bond issue.

Foreign Issuers

Foreign companies whose securities are listed on the Nigerian Stock Exchange are under the same disclosure obligations as are applicable to Nigerian listed companies.

Default in Disclosure Requirements

Where a listed company defaults in its reporting obligations, the practice of the Nigerian Stock Exchange is to invite the company secretary to give reasons for the default and to grant such extension of time as is necessary for the necessary returns to be made. Where there is continued default, the Nigerian Stock Exchange would formally invite the management of the company for discussions to determine, and possibly resolve, the reasons for the default.

It is only in extreme situations that the Nigerian Stock Exchange would exercise its power to order a technical suspension of trading in the shares of a defaulting company. However, recent developments suggest a changing disposition of the regulatory bodies to persistent default by listed companies in their reporting obligations, as the Securities and Exchange

116 Rules Governing Listing on the Nigerian Stock Exchange, item 1, appendix III.

Commission recently recommended that the Nigerian Stock Exchange de-list from the official list 41 'moribund' companies that had consistently defaulted in submitting their quarterly and half-yearly reports to the Nigerian Stock Exchange.

Proxy Disclosure

The provisions of the Companies and Allied Matters Act permit a shareholder of a listed company to appoint another person (whether a shareholder or not) to represent him and exercise voting rights at a shareholders' meeting.[117] The Securities and Exchange Commission Rules and Regulations make detailed provisions relating to the proxy statement, the proxy form, and any solicitation of proxies by the management of a company.[118] The Registrar of a listed company is obliged to file with the Securities and Exchange Commission a copy of the proxy statement, proxy form, and all other soliciting materials not later than 48 hours before despatching the documents together with the notice of the meeting to the shareholders.[119]

The Listing Requirements also provide that every listed company must send out proxy forms to all shareholders entitled to attend and vote at general meetings of the company and ensure that such proxy forms are appropriately worded as to enable a shareholder or debenture holder to vote either for or against each resolution.[120] Nor may the articles of association of a listed company be worded so as to preclude the use of such two-way proxy form.[121] The Securities and Exchange Commission Rules and Regulations also contain detailed provisions on the contents of every proxy statement or material used in the solicitation of proxies.[122]

Trading Rules

Securities Offerings

Offer. The issue of securities can be made either publicly or privately. The term 'private placement' refers to the issue of securities that do not involve a public offering.[123]

No issuer is permitted to offer for sale or subscription or sell securities whose aggregate offer value is N 25 million and above by way of private placement without obtaining prior written approval from the Securities and Exchange Commission. Such approval will not be given if the private offering does not meet the criteria and requirements under Rules 91–97 of the Securities and Exchange Commission Rules and Regulations.[124]

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117 Companies and Allied Matters Act, s 230. The articles of association of a company may not limit this right, and the company is under an obligation to restate the right of appointment of proxies in the notices convening its general meetings.
118 Securities and Exchange Commission Rules and Regulations, rules 285–293.
119 Securities and Exchange Commission Rules and Regulations, rules 289 and 290.
120 Rules Governing Listing on the Nigerian Stock Exchange, item 1(d)(i), appendix III.
121 Rules Governing Listing on the Nigerian Stock Exchange, item (k), appendix VII.
122 Securities and Exchange Commission Rules and Regulations, rule 293.
123 Securities and Exchange Commission Rules and Regulations, rule 89(1).
124 Securities and Exchange Commission Rules and Regulations, rule 90.

No issuer or person acting on its behalf in making a private placement offer is permitted to offer the securities for subscription or sale in any manner denoting a public invitation. These forms of public invitation, general solicitation, or general advertising include:

- Any advertisement, article, notice, or other communication published in any newspaper, magazine, or broadcast over the television or radio; and
- Any seminar or meeting to which those attending have been invited by any general solicitation or general invitation.[125]

The number of purchasers to whom the securities are offered by private placement should not exceed 50.[126] In line with the Securities and Exchange Commission objectives to ensure fairness in the capital market, for the purposes of calculating the number of purchasers, the following categories of purchasers are excluded:

- Any relative, spouse, or relative of the purchaser's spouse who has the same principal residence as the purchaser;
- Any trust or estate in which a purchaser and any of the persons related to him, as indicated above, collectively have more than 50 per cent of the beneficial interest (excluding contingent interests);
- Any corporation or other organisation of which a purchaser and any of the persons related to him collectively are beneficial owners of more than 50 per cent of the equity securities (excluding directors' qualifying shares or equity interests); and
- Any accredited investor.

'Accredited investors' are persons or institutions that are capable of understanding and affording the financial risks associated with acquisition of unregistered securities. These include financial institutions, executive officers of issuing houses, natural persons with a net worth of over N 2 million, natural persons with incomes exceeding N 400,000 or N 500,000 for single and married persons, respectively, trust or business partnerships with net assets of more than N 5 million, and entities in which all the owners are accredited investors.

However, for the purpose of calculating the number of purchasers, corporations, partnerships, and other entities (that are not accredited investors) are regarded as one purchaser. Such 'other entities' do not include entities that are organised for the specific purpose of acquiring the securities offered.

Prior to making an offer and subsequent sale, the issuer or any person acting on its behalf should have reasonable grounds to believe that the offeree has sufficient knowledge and experience in financial business matters to evaluate the merits and demerits of the prospective investments. The issuer should also believe in the offeree's ability to bear the economic risk of the investments.[127]

Each offeree is entitled to have reasonable access to the same kind of information included in a placement memorandum or offering document describing the terms and

125 Securities and Exchange Commission Rules and Regulations, rule 91.
126 Securities and Exchange Commission Rules and Regulations, rule 91 (as amended).
127 Securities and Exchange Commission Rules and Regulations, rule 93.

conditions of the offering. At a reasonable time before the sale of the securities, the issuer is expected to furnish this information to the offeree to such extent that will enable the offeree to have a proper understanding of the issuer, its business, and the securities being offered.[128]

The issuer is required to exercise reasonable care to ensure that the purchasers of the securities are not and do not become underwriters.[129]

The issuer must file two copies of the private placement memorandum with the Securities and Exchange Commission.[130] The private placement memorandum and all the accompanying documents must not contain any false or misleading statement or information. The issuer must file a report of a sale of the securities in the offering, within 10 working days of the close of the offer (and no longer than after 10 days of the sale of the securities) with the Securities and Exchange Commission.[131] The report must contain the following information:

- Names and addresses of the parties to the offer;
- Basic information about the issuer;
- Information about the offering, such as offer price, volume of securities, and number of investors;
- Cost of issue and use of proceeds;[132]
- Name and addresses of the purchasers;
- Amount purchased and the mode of payment;
- Time of payment;
- Nature of the purchaser; and
- Amount the company is raising.[133]

Issuers are restricted from making more than one private offering within any year.[134] This provision restricts the free transaction in private securities. Some issuers may have more investments to manage than others, and being limited to making one private offering in a year will defeat the objective of assisting members of the private sector to secure long-term funds through the issue of securities.

Invitations to the Public. Section 44 of the Investments and Securities Act provides that:

> . . . [n]o person shall make any invitation to the public to acquire or dispose of any securities of a body corporate; or to deposit money with any body corporate

128 Securities and Exchange Commission Rules and Regulations, rule 94.
129 Securities and Exchange Commission Rules and Regulations, rule 95.
130 Securities and Exchange Commission Rules and Regulations, rule 96.
131 Securities and Exchange Commission Rules and Regulations 1999, rule 96(2), part B3, as amended.
132 The report must be signed by a person or persons duly authorised to do so by the issuer.
133 Securities and Exchange Commission Rules and Regulations 1999, rule 96(2), part B3, as amended.
134 Securities and Exchange Commission Rules and Regulations, rule 97.

> for a fixed period or payable at call, whether bearing or not bearing interest unless the body corporate concerned:
>
> (i) is a public company and the provisions of sections 50-63 of this Act on the prospectus requirements are duly comprised with, or
>
> (ii) is a body corporate licensed under the Banks and other Financial Institutions Act Number 25 of 1991 to carry on banking business.

A public offering can only arise where an invitation or offer is made to the public. Invitations are made to the public where an offer or invitation is:

- Published, advertised, or disseminated by newspaper, broadcasting, cinematography, or any other means;
- Made to or circulated among any persons whether selected as members or as debenture holders of the company concerned or as clients of the persons making or circulating the invitation or in any other manner;
- Made to any one or more persons on the terms that the person or persons to whom it is made may renounce or assign the benefit of the offer or invitation or any of the securities to be obtained under it in favour of any other person or persons; or
- Made to any one or more persons to acquire any securities dealt in by a securities exchange or capital trade point or in respect of which the invitation states that the application has been or will be made for permission to deal in those securities on a securities exchange or capital trade point.[135]

In addition, where any company allots or agrees to allot any of its securities to any person with a view to inviting the public to acquire any of those securities, such an invitation also would constitute an invitation to the public.[136] However, invitations are not regarded as being 'made to the public' where:

- In the circumstances, the offer or invitation is not being calculated to result, directly or indirectly, in shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation, or otherwise as being a domestic concern of the persons making and receiving it;[137] and
- The invitation is made by or on behalf of a private company exclusively to its existing shareholders.

It is unlawful to issue any form of application for securities in a public company unless the form is issued with a prospectus prepared in accordance with the Investments and Securities Act.

Listed Securities. All securities for which listing on the Nigerian Stock Exchange is sought must first be registered with the Securities and Exchange Commission. Only

135 Investments and Securities Act, 1999, s 46(1).
136 Investments and Securities Act, 1999, s 47.
137 Investments and Securities Act, 1999, s 46(2).

public companies which will issue or have issued an invitation to the public to subscribe for their shares or have satisfied the Nigerian Stock Exchange Council that the public is sufficiently interested in the company's shares will obtain listing on the Nigerian Stock Exchange.[138]

Before listing is granted to an applicant company, it must sign a General Undertaking that it will provide certain information about its operations and follow certain administrative procedures.

Listing Methods. The methods for listing of securities on the Nigerian Stock Exchange include:

- Offer for subscription— an invitation by or on behalf of a company or other authority to the investing public to subscribe to its securities at a fixed price;
- Offer for sale — an offer made by or on behalf of a shareholder to the public, the proceeds thereof going to the vendor;
- Placing — the sale by a broker to its clients of securities that have already been subscribed for or purchased;
- Rights offer or issue — a privileged offer to existing shareholders to acquire proportionately additional shares in the company, usually at a special price;
- Capitalisation issue — a bonus issue to existing shareholders;
- Tender — an offer of a specific quantity of shares or stock to the public by or on behalf of a company or other authority to a third party for bidding;
- Introduction — a listing of securities already widely held;
- Conversion — an exchange for or conversion of securities into other classes of securities;
- Option — an offer to buy or sell some shares at an agreed price and time; and
- Any other method that the Council or Committee of the Nigerian Stock Exchange may prescribe.[139]

A company may apply to be listed on the First-Tier Securities Market or the Second-Tier Securities Market of the Nigerian Stock Exchange. The requirements for listing on the First-Tier Market are as follows:

- The company must be registered as a public limited liability company under the provisions of the Companies and Allied Matters Act;
- The company must submit to the Nigerian Stock Exchange its financial statements and business records for five years before the date of the application;
- The date of last audited accounts may not exceed nine months;
- The amount of money that can be raised is unlimited depending on the borrowing power of the directors or company;
- The company must pay its annual quotation fees based on market capitalisation;

138 Rules Governing Listing on the Nigerian Stock Exchange, at p 7.
139 Rules Governing Listing on the Nigerian Stock Exchange, at p 3.

- At least 25 per cent, or N 250,000, of nominal value of share capital must be offered to the public;
- The number of shareholders may not be less than 500;
- After listing, the company must submit quarterly, half-yearly, and annual accounts;
- The securities must be fully paid-up at the time of allotment;
- The unalloted securities must be sold on the Nigerian Stock Exchange's trading floors; and
- There must be provision for issue of mergers, acquisitions, unit trusts, or mutual funds.

In addition to the usual listing requirements for corporate entities, the Nigerian Stock Exchange also requires that all applications for state government bonds should be submitted together with four proof prints of a prospectus prepared in accordance with the Securities and Exchange Commission Rules and Regulations. These proofs must be submitted at least 30 days before the prospectus is published.

For listing on the Second-Tier Market:

- The company must be registered as a public limited liability company under the provisions of the Companies and Allied Matters Act, 1990;
- The company must submit to the Exchange financial statements and business records of the past three years;[140]
- The date of last audited accounts may not exceed nine months;
- The amount of money that can be raised may not exceed N 10 million;
- The annual quotation fee must be a flat rate of N 5,000;
- At least 10 per cent nominal value of share capital must be offered to the public;
- The number of shareholders may not be less than 100;
- After listing, the company must submit half-yearly and annual accounts;
- The securities must be fully paid-up at the time of allotment; and
- The unalloted securities must be sold on the Nigerian Stock Exchange's trading floors.

Application for Listing. The company's application for listing must be sponsored by a dealing member of the Nigerian Stock Exchange and be accompanied by the application fees. The application must be prepared in compliance with the listing requirements and accompanied by the documentation required by the Nigerian Stock Exchange.[141]

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140 In certain cases, fresh companies may be considered for listing.

141 These documents include 10 copies of the abridged application for quotation and listing on the Nigerian Stock Exchange, two copies of the applicant's certificate of incorporation evidencing its public limited company status, and two copies of the Memorandum and articles of association; a draft of a Trust Deed (in the case of loan stock or debenture), a certified true copy of the resolution authorising the issue of securities for which listing is sought, issue of the prospectus and the increase of share capital to absorb the proposed issue, a copy of the account for the five years preceding the date of the application, a copy of the draft underwriting agreement, and a copy of the Reporting Accountants' statement on the financial results; a copy of the pricing proposal submitted to the Securities and Exchange Commission, a copy of the draft prospectus, the estimated cost of the issue, the offer timetable, and a certified copy of every report, the valuation referred to in the prospectus, and consent letters from all the parties to the issue.

When the relevant portions of the Listing Requirements have been met and submitted to the Nigerian Stock Exchange, the Quotations Department will carry out a detailed analysis of the application documents and prepare an Appraisal Report, recommending approval of the application[142] to the Quotations Committee of the Nigerian Stock Exchange Council. The Quotation Committee, based on the independent opinion formed from the Quotations Department's Appraisal Report, will approve or reject the application.

After the Quotation Committee approves, the Nigerian Stock Exchange will issue a letter of approval to indicate that the issue may proceed. The applicant also is required to submit its allotment proposal to the Securities and Exchange Commission for approval. Once the approval has been obtained, the following documents must be filed with the Nigerian Stock Exchange before listing can be granted:

- Copy of the approved allotment proposal;
- Newspaper cutting of the announcement of the allotment in the newspapers;
- General undertaking signed by the managing director or company secretary of the applicant company; and
- Declaration of compliance in the prescribed form.

When all the requirements have been complied with, then the stockbrokers can apply for the date of listing through a registered issuing house. An application filed for the listing of securities on the Nigerian Stock Exchange will be deemed to apply to the listing of the class of the securities, and listing will become effective as to the shares or amounts of such class when issued (including additional shares or amounts of such class then or thereafter authorised) on listing.[143]

Admission to Listing. Companies admitted to listing on the Nigerian Stock Exchange also are required to pay a listing fee. Since the Investments and Securities Act does not prohibit dual listing, the Securities and Exchange Commission Rules and Regulations permit issuers and public companies to list their securities on more than one exchange provided that the issuer complies with the listing requirements of the relevant exchange.[144] By so doing, the Securities and Exchange Commission has recognised that the venue for listing of securities is purely a business decision of the issuer or company.

Certification that securities have been approved for listing is made by the Nigerian Stock Exchange Governing Council.[145] The Nigerian Stock Exchange is empowered to withdraw the certification by notice to the Securities and Exchange Commission before the listing becomes effective. The Nigerian Stock Exchange also is empowered to de-list listed securities after written notification to the Securities and Exchange Commission,

142 Where the Quotations Department is of the opinion that the application does not merit the Quotations Committee's attention, the applicant is invited for further discussions or advice on restructuring the application.
143 Securities and Exchange Commission Rules and Regulations, rule 125.
144 Securities and Exchange Commission Rules and Regulations, rule 109(C).
145 Securities and Exchange Commission Rules and Regulations, rule 126.

seven days before the action is taken. However, this notification will be unnecessary where the order to de-list the securities has been given by a court of law or other governmental authority, in which case the order would be final.

Listed companies are required to enter into a covenant to provide the Nigerian Stock Exchange and the investing public with material information about their activities at the time of seeking and, thereafter, for retaining listing.[146] Listed companies also are required to advertise conspicuously the Notice of their annual general meeting in two widely read newspapers at least seven days before the meeting.

Unlisted Securities. Securities that are not listed on the Nigerian Stock Exchange include securities of private companies that are not required under law to be listed and those of unquoted public companies.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties. Section 95 of the Companies and Allied Matters Act imposes an obligation on a person who is a substantial shareholder in a public company to give notice in writing to the company stating his name and address and giving full particulars of the shares held by him. If the shares are held through a nominee, the notice must name the nominee.[147] A person is a substantial shareholder if the shares held by him or his nominee entitle him to exercise at least 10 per cent of the unrestricted voting rights at any general meeting of the company.[148]

The notice must be given within 14 days after the shareholder becomes aware that his shareholding is substantial and must be given notwithstanding that he ceases to be a substantial shareholder before the expiration of this period.[149] Failure to give the notice is an offence punishable under section 95(5) of the Companies and Allied Matters Act and involves payment of a fine of N 50 for every day that the default continues.

Furthermore, under section 96, a person who ceases to be a substantial shareholder in a public company must notify the company in writing, stating his name and the date on which he ceased to be a substantial shareholder and the circumstances by reason of which he ceased to be a shareholder. The notification must be made within 14 days.[150]

The disclosure requirements stipulated by sections 95 and 96 of the Companies and Allied Matters Act only oblige the substantial shareholder to notify the company of his acquisition (and divestment) of substantial shareholding. There is no corresponding obligation to notify the Corporate Affairs Commission, the Securities and Exchange Commission, or any other regulator of either the shareholder or the company.

146 Rules Governing Listing on the Nigerian Stock Exchange, at p iv.
147 Companies and Allied Matters Act, 1990, s 95(1).
148 Companies and Allied Matters Act, 1990, s 95(2).
149 Companies and Allied Matters Act, 1990, s 95(3) and (4).
150 Companies and Allied Matters Act, 1990, s 96(2).

However, the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations require a person or company that seeks to acquire substantial shareholding to notify the Securities and Exchange Commission both before and after he makes the acquisition. The disclosure requirements here are activated on a proposal for a take-over, merger, or other combination. The rules basically require that the Securities and Exchange Commission be informed of the proposed arrangement and that its approval to the scheme be obtained.[151]

Company Duties. Rule 109(A) of the Securities and Exchange Commission Rules and Regulations provides that public companies quoted on the Stock Exchange should notify the Securities and Exchange Commission of any beneficial owners holding five per cent or more of a company's shares. In addition, notification on any subsequent transaction in such shares also must be filed.[152] The information must be filed within five days of the initial acquisition or subsequent change of ownership.[153]

Furthermore, chapter 4, rule 14, of the Rules Governing Listing on the Nigerian Stock Exchange requires disclosure of substantial shareholding where listing is sought for securities of a company some part of whose capital is already listed on the Stock Exchange. In such cases, the prospectus by which the offer is made shall include a statement to the persons holding or beneficially interested in any substantial part of the share capital of the company and the amounts of the holding in question. The Listing Rules do not define what amounts to a substantial shareholding in this regard.

Insider Trading and Fraud

Definition and Regulation. Insider trading occurs when a person (or group of persons), in possession of certain confidential price-sensitive information relating to a company's securities, utilises such information to buy or sell, or otherwise deal in the securities of such company, for the benefit of himself, itself, or any person.[154] An individual is an 'insider' if he is, or at any time within the preceding six months has been, knowingly connected with the company whose securities are traded in any of the following capacities[155] and has, by virtue of such connection, obtained unpublished price-sensitive information in relation to the securities of the company:

- A director, officer, or employee of the company or a related company;[156]
- A person in a position involving a professional or business relationship with the company or a related company; and

151 Investments and Securities Act, 1999, ss 99–122; Securities and Exchange Commission Rules and Regulations, rule 235(3)(a), part G2, as amended.
152 The notification is done by completing and filing Form 6(B) with the Securities and Exchange Commission. Securities and Exchange Commission Rules and Regulations, rule 109(A)(ii).
153 Securities and Exchange Commission Rules and Regulations, rule 109(A)(iii).
154 Investments and Securities Act, 1999, s 264.
155 Investments and Securities Act, 1999, s 295(2); Securities and Exchange Commission Rules and Regulations, rule 110(3).
156 'Related company' is defined as a subsidiary or holding company and includes a subsidiary of the holding company; Investments and Securities Act, 1999, s 95(1).

- A shareholder who owns five per cent or more of any class of securities of the company or the agent of such shareholder.

The Investments and Securities Act prohibits an insider from buying or selling or otherwise dealing with the securities of the company which are offered to the public for subscription.[157] In addition, an insider may not counsel or procure another person to deal in the securities of the company nor communicate confidential information to any other person where he knows or has reasonable cause to believe that the other person will make use of the information in relation to the securities of the company.[158] A person who knowingly obtains confidential information from an insider also is prohibited[159] from doing any of the following acts:

- Directly dealing in the securities of the company;
- Counselling or procuring any other person to deal in the securities of the company;
- Communicating confidential information to another person where he knows or has reasonable cause to believe that the other person will make use of the information with regards to the securities of the company; and
- Dealing in the securities of any other company involved in an actual or contemplated transaction with the primary insider's company, where such person is in possession of unpublished price-sensitive information in relation to the securities of that other company.[160]

A person who is contemplating or has contemplated making a take-over bid for a company in a particular capacity cannot deal in the securities of that company in another capacity where the offer is price-sensitive information in relation to the securities of the target company.[161] Any person who directly or indirectly obtains such information from him also is prohibited from dealing in the securities of the target company.[162] Furthermore, a person involved in securities trading is prohibited from engaging in manipulative and deceptive practices including dealing in the securities of any company of which he is an insider.[163]

Exemptions. Persons who possess price-sensitive information relating to the securities of a company, and who act on such information, are expressly excluded from the prohibitions on insider trading in the following instances:

- Acts done without any motive for financial gain or avoidance of financial loss;

157 Investments and Securities Act, 1999, s 88(1). The Securities and Exchange Commission Rules and Regulations, in rule 110(2), describe insider trading to include dealings in the Nigerian Stock Exchange and off-market dealings.
158 Investments and Securities Act, 1999, s 88(6) and (7).
159 Investments and Securities Act, 1999, s 88(2) and (3).
160 A public officer or former public officer who is in possession of price-sensitive information obtained in his official capacity also is prohibited from doing any of these except the last mentioned, acts; Investments and Securities Act, 1999, s 89.
161 Investments and Securities Act, 1999, s 88(4).
162 Investments and Securities Act, 1999, s 88(5).
163 Securities and Exchange Commission Rules and Regulations, rule 110(1)(e).

- Transactions entered in good faith in the ordinary course of the exercise of the functions of a liquidator, receiver, or trustee in bankruptcy;
- Acts done in good faith and based on information obtained in the ordinary course of a business (including that of a stock broker); and
- Acts of a trustee or personal representative or agents of such, done without any motive for financial gain and based on the advice of a qualified person who himself is not prohibited from dealing in such securities.[164]

Civil Liability and Penal Provisions for Insider Trading. The Investments and Securities Act provides that no transaction shall be void or voidable for the sole reason that it was entered into in contravention of the provisions of the Act prohibiting insider trading.[165] An aggrieved party is, therefore, prevented from rescinding the actual transaction leading to his loss and claiming the contract sum.

However, apart from any liability incurred under any other law, an insider or any other person who contravenes any of the provisions of the Investments and Securities Act relating to insider trading is guilty of an offence and liable on conviction to pay compensation to any such person who has directly suffered loss as a result of the transaction in question.[166]

Either the Securities and Exchange Commission or the Investment and Securities Tribunal will determine the amount payable as compensation. An aggrieved person who is shown to have known, or could have known, with the exercise of reasonable diligence, about the price-sensitive information that resulted in his loss is barred from claiming any compensation for the loss. In addition, an aggrieved person is prevented from commencing an action for recovery of loss at the Tribunal until at least two years after the date of the completion of the transaction in which the loss occurred.[167] Criminal conviction under the provisions of the Investments and Securities Act incurs a fine of either of, or both, a fine of N 1 million or two years' imprisonment.[168]

Extraterritorial Application. The prohibition on insider trading applies to trading in the securities of any company listed on the Nigerian Stock Exchange, and it is immaterial whether the transaction was conducted outside Nigeria or that the insider is resident outside Nigeria.

Public Take-Over Bids

In General. Although the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations contain extensive provisions on take-overs, there has

164 Investments and Securities Act, 1999, ss 90 and 91.
165 Investments and Securities Act, 1999, s 92.
166 Investments and Securities Act, 1999, s 93(1). Under section 93(2), such person also is accountable to the company for the direct benefit or advantage received or receivable by him as a result of the transaction.
167 Investments and Securities Act, 1999, s 93(1)(a).
168 Investments and Securities Act, 1999, s 94.

not been a single case of an actual take-over in line with these provisions in Nigeria. The Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations empower the Securities and Exchange Commission to generally regulate any take-over of a public company in Nigeria.

'Take-over' is defined as the acquisition by one company of sufficient shares in another company to give the acquiring company control over that other company.[169] Section 104 of the Investments and Securities Act provides that a take-over bid will be deemed to be made where the targeted shares would vest in the offeror more than one-third of the issued shares (or class of shares) of the company. The Securities and Exchange Commission's position is that the primary issue is whether the motive behind any acquisition of shares is control of the target company or purely for reasons of investment.

Where the acquisition is made for investment purposes, it will not be deemed to be a take-over under the Investments and Securities Act. Every take-over bid is subject to prior review and approval of the Securities and Exchange Commission. In performing this supervisory role, it is the responsibility of the Securities and Exchange Commission to ensure that any acquisition of shares through a take-over bid does not create substantial restraint of competition or a monopoly in any line of business enterprise.[170]

Territorial Application (Foreign Bidder — Domestic Target). The provisions of the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations relating to take-over apply to all public companies in Nigeria. Thus, it is immaterial whether a Nigerian company or a foreign company initiates the bid.

Following the liberalisation of the Nigerian economy and the enactment of the Nigerian Investment Promotion Commission Act, 1995, which allows 100 per cent foreign shareholding of Nigerian companies, a foreign entity can make a take-over bid for all the available shares in a Nigerian target company.

Procedural Requirements. Any person, group of persons, or corporate body ('offeror') intending to acquire control of a target company by means of a take-over must first make a written application to the Securities and Exchange Commission for authority to proceed with the take-over bid.[171] The application must state the name or names and other particulars of the offeror, the particulars of the proposed bid, and any other information required by the Securities and Exchange Commission.[172]

In deciding whether to grant the authority to proceed with a take-over bid, the Securities and Exchange Commission's sole consideration should be the likely effect of a successful take-over bid on the economy of Nigeria and on any policy of the federal government of

169 Investments and Securities Act, 1999, s 99(1).

170 Investments and Securities Act, 1999, s 99(2) and (3); Securities and Exchange Commission Rules and Regulations, rule 229(1) and (2).

171 Investments and Securities Act, 1999, s 105; Securities and Exchange Commission Rules and Regulations, rule 237. The directors of the company must have passed a resolution approving the take-over bid before the application is made to the Securities and Exchange Commission.

172 The Securities and Exchange Commission also may request additional supporting documentation.

Nigeria relating to manpower and development.[173] The Securities and Exchange Commission will issue a 'no objection letter' if it is satisfied that those issues are not compromised.

After the authority to proceed is granted, the offeror must within three months forward a copy of the bid to the Securities and Exchange Commission for registration.[174] The Securities and Exchange Commission will register the bid where it is satisfied that the proposed transaction comes within the provisions of the Investments and Securities Act relating to take-over. It is only after registration is obtained that the bid will be despatched to the necessary parties.

The bid may be expressed either as an 'invitation' or an 'offer'. It is unclear from the provisions of the Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations what the actual distinction is between these two types of a bid. However, it is presumed that a bid which is an offer expresses an offeror's binding intention to take up all shares deposited pursuant to the bid, while a bid which is an invitation merely conveys an offeror's willingness to take up a certain number of shares deposited pursuant to the bid, subject to certain conditions of the bid being fulfilled. Generally, a bid may be made unconditionally or may be dependent on a specified minimum acceptance. The offer document conveying the bid must state[175] the following:

- The full name or names and address of the offeror;
- Where the offeror is a company, the date at which the approval of its directors was given to the take-over bid;
- The number (or, in the case of an invitation, the maximum number) and other particulars of the shares of the target company proposed to be acquired during the specified period;
- The consideration and other terms of the offer (or proposed acquisition, in the case of an invitation);
- The number and other particulars of the shares of the target company which the offeror (or any associate company) is or are entitled to, immediately before the date of the take-over bid;
- The intention of the offeror to invoke the right granted by the Investments and Securities Act to compulsorily acquire the shares of dissenting shareholders;[176] and
- The intention of the offeror to purchase shares of the target company in the stock market during the period within which shares may be deposited pursuant to the bid.

173 Investments and Securities Act, 1999, s 105(6). However, the overriding consideration of the possible anti-competitive effects of the bid would still be relevant.

174 Investments and Securities Act, 1999, s 106; Securities and Exchange Commission Rules and Regulations, rule 238. The bid must be despatched within three months after obtaining the authority to proceed unless an application is made for renewal of the authority to proceed.

175 Investments and Securities Act, 1999, s 107; Securities and Exchange Commission Rules and Regulations, rule 236. Whether a bid is an invitation or an offer has little effect on these requirements.

176 Investments and Securities Act, 1999, s 117. This is only possible where the bid is for all the shares (or a class of shares) of the target company.

Where the target company is a company listed on the Nigerian Stock Exchange, additional disclosure requirements are prescribed by the Nigerian Stock Exchange Listing Requirements, and these include:

- A statement on any direct or indirect beneficial interest of the directors of the offeror in the shares of the target company;
- The details of transactions in the shares of the target company, made within 12 months prior to the take-over bid, involving the offeror, its directors, or associate companies;
- A statement on any intention to transfer the shares acquired by virtue of the bid to another entity and particulars of such entity, including details of its shareholding in the target company;
- The intention of the offeror regarding the employees of the target company and the continuation of the business;
- Where the consideration for the shares of the target company consists of shares in the offeror company, a statement on the nature and particulars of the offeror company's business, including its net profit before tax, rate per cent of dividends on its shares, and amount distributed, for the previous three years; and
- Any other information requested by the Nigerian Stock Exchange.[177]

The Securities and Exchange Commission Rules and Regulations provide that a take-over bid may be made directly or through a registered capital market operator (capital market operator).[178] It is, therefore, the responsibility of the capital market operator to simultaneously despatch a copy of the bid to each director and shareholder of the target company, the Securities and Exchange Commission, and the Nigerian Stock Exchange (where the target is a listed company).[179] The resolution of the directors of the offeror, approving the bid, also must be despatched with the bid.[180] The take-over bid must be advertised in at least two national daily newspapers.

On receipt of the bid, the directors of the target company are required to prepare a directors' circular, reflecting their opinion on the bid, which will be despatched to each shareholder of the company, the Securities and Exchange Commission, and the Nigerian Stock Exchange (where the company is a listed company). If the directors fail to reach a unanimous decision on whether or not the take-over is advantageous to the shareholders of the company, a directors' circular reflecting the recommendations of the majority must be approved and despatched. A dissenting director is, however, entitled to indicate his opinion or disagreement, in a statement setting out his reasons for such, in the directors' circular.[181] The directors' circular must include particulars of any payments made to any

177 Nigerian Stock Exchange Listing Requirements, ch 5.
178 Securities and Exchange Commission Rules and Regulations, rule 235(1).
179 Investments and Securities Act, 1999, s 109; Nigerian Stock Exchange Listing Requirements, ch 5.
180 Securities and Exchange Commission Rules and Regulations, rule 235(2). At least one director and the company secretary must sign the resolution.
181 Investments and Securities Act, 1999, s 111(4).

officer or former officer of the target company as compensation for loss of office or as consideration for, or in connection with, his retirement from office.

There is no statutory provision prohibiting the management of the target company, after receiving the bid, from taking certain steps or entering into certain transactions, within the period specified by the bid for the deposit of shares, which will directly or indirectly undermine the bid, such as issuing new shares, charging significant assets of the company as liabilities, or executing contracts which are beyond the ordinary business of the company. However, if the Securities and Exchange Commission becomes aware of such acts, it will invoke its general supervisory powers to restrain the management from embarking on or continuing with such conduct.

The consideration for the shares of the target company would normally be cash payment, but the bid may be made for a consideration other than cash, such as shares in the offeror company. Uniform consideration must be offered to all the shareholders and, where the terms of the bid are amended by increasing the consideration, the offeror must pay the increased consideration to each shareholder whose shares are taken up pursuant to the bid, whether or not such shares were taken up prior to the amendment.[182] Where, during the offer period, the offeror purchases shares in the target company through means other than the bid and pays a higher consideration for those shares than that offered by the bid, the bid will be deemed amended and the offeror must pay an increased consideration for the shares taken up pursuant to the bid.[183]

The period of time within which shares may be deposited pursuant to a take-over bid may not be less than 21 days after the date of the bid.[184] Where the bid is for less than all the shares (or a class of shares) of the target company, the maximum period within which shares may be deposited is 35 days after the date of the bid.[185]

The offeror is bound to take up the shares deposited, subject to any condition stipulated in the bid, and make payment for those shares within 14 days of the expiration of the time stipulated for the deposit of shares. Where the bid is for all the shares (or a class of shares) of the target company, the offeror is precluded from taking up shares deposited until 10 days after the date of the bid; where the bid is for less than all the shares (or a class of shares), the offeror cannot take up shares deposited until 21 days after the date of the bid. The members of the target company are, however, at liberty to withdraw their shares within 10 days of the date of the bid; where the bid is for all the shares (or a class of shares), shareholders are permitted to withdraw shares deposited at any time on the expiration of 60 days from the date of the bid.

The offeror is permitted, with the Securities and Exchange Commission's consent, to amend the terms of the bid including the period of time within which shares may be

182 Investments and Securities Act, 1999, s 115(e).
183 Investments and Securities Act, 1999, s 115(f)(i).
184 This is deemed to be the date on which the bid is despatched; Investments and Securities Act, 1999, s 103(2).
185 There is no prescribed maximum period where the bid is for all the shares (or a class of shares) of the target company.

deposited and also is entitled to waive certain terms of the bid.[186] Where a bid is for less than all the shares (or a class of shares) of the target company, and a greater number of shares is deposited than the offeror is bound or willing to take up, the offeror is bound to take the shares on a pro-rated basis, according to the number of shares deposited by each shareholder.

Compulsory Acquisition. Where, by virtue of a bid made for all the shares (or a class of shares) of the target company, the offeror becomes entitled to at least 90 per cent of those shares, the offeror is entitled, within one month of obtaining the requisite number of shares, to give notice to the remaining shareholders of the target company requesting that they make an election as to the terms of the transfer of their shares to the offeror, ie, whether to transfer at the same consideration as offered under the bid or to demand payment of a fair value for the shares as determined by the Federal High Court.[187] Irrespective of the election made, all affected shareholders must forward their respective share certificates to the target company within 20 days of service of the notice on them.[188]

A shareholder who does not exercise his right of election is deemed to have agreed to a transfer of his shares on the terms of the bid. The offeror must, within 20 days of serving the notice, pay or transfer an equal cash payment or other consideration as that offered under the bid to the offeror company, to be held in trust for the affected shareholders.

In the event that an offeror who has acquired at least 90 per cent beneficial interest in the target company does not exercise the right to serve the remaining shareholders with the notice discussed above or does not serve all the remaining shareholders with the notice, the law requires the offeror to give notice of the fact that it has acquired such percentage of shares to the remaining shareholders within two months of acquiring those shares. Within two months of receiving the notice, the remaining shareholders are entitled to give the offeror notice requiring that it acquire their shares on the same terms as that of the bid or as agreed between the parties or as fixed on the application of either of the parties.[189] Once a shareholder gives such notice, the offeror is bound to acquire his shares, subject to the determination of the consideration.

Exemptions. The take-over procedure outlined above will not be required where:

- The acquisition involves the participation of a holding company, and the acquisition is for the purpose of investment, and not for the creation of restraint in competition or monopolies in any line of business enterprise; and

186 The waiver is subject to the express provisions of the Investments and Securities Act, 1999, and the Securities and Exchange Commission Rules and Regulations.
187 Investments and Securities Act, 1999, s 117.
188 Failure to do this will result in the cancellation of the share certificates and the effective transfer of the shares to the offeror, although the shareholders are still entitled to the appropriate consideration.
189 Investments and Securities Act, 1999, s 121.

- The transaction is conducted under the authority of any federal government agency vested with the statutory power to approve such transactions.[190]

Furthermore, a take-over bid will not be deemed to have been made where:

- The bid is despatched to less than 20 members representing 60 per cent of the members of the target company;[191]
- The bid is despatched to purchase shares in a company which has fewer than 20 members;[192] and
- The shares to be acquired under the bid are shares in a private company.[193]

Recognition of Foreign Take-Over Regulation. The Investments and Securities Act and the Securities and Exchange Commission Rules and Regulations make no provision for the take-over of a listed foreign company.

However, it is presumed that the law of the place of incorporation or the regulations of the primary market of such company would be applicable to such bid. The Securities and Exchange Commission and the Nigerian Stock Exchange should, however, be formally notified before the process is initiated and where the bid is successful.

Jurisdictional Conflicts

In General

There is little literature on jurisdictional conflicts with regard to securities regulation in Nigeria. This is mainly because the Nigerian securities market is just coming into its own, and it has not generated a sufficient volume of litigation or overseas participation to sustain such discussions on an on-going basis. Jurisdictional conflicts could arise in a number of contexts, both domestic and international. These include:

- Domestic conflicts relating to the appropriate court within Nigeria that should exercise jurisdiction in disputes relating to securities transactions;
- Conflicts in the requirements of various stock exchanges both within and outside Nigeria; and
- Private international law conflicts relating to the law applicable to securities contracts with an international flavour, the appropriate jurisdiction to refer disputes relating to these conflicts, the procedural rules applicable in such cases, and the enforcement of cross-border judgments and awards in these contexts.

190 Investments and Securities Act, 1999, s 99(3) and (4); Securities and Exchange Commission Rules and Regulations, rule 230.
191 Investment and Securities Act 1999, ss 99–122; Securities and Exchange Commission Rules and Regulations 1999, rule 235(3)(a), part G2, as amended.
192 Investments and Securities Act, 1999, s 104(3)(b).
193 Investments and Securities Act, 1999, s 104(4); Securities and Exchange Commission Rules and Regulations, rule 235(3)(b).

Domestic Conflicts

Section 251(1)(e) of the Constitution of the Federal Republic of Nigeria, 1999, vests exclusive civil jurisdiction in the Federal High Court over matters relating to the operation of the Companies and Allied Matters Act and any enactment replacing it or regulating the operation of companies incorporated under the Act. Part XVII of the Companies and Allied Matters Act was repealed by the Investments and Securities Act,[194] and matters hitherto contained therein are now regulated by the Investments and Securities Act.

It may, therefore, be correct to suggest that the Federal High Court will have jurisdiction, to the exclusion of any other court or tribunal, in respect of civil actions arising from the above matters. Apart from the above matters, the exclusive jurisdiction also vested in the Federal High Court in respect of civil actions 'arising from the operation of . . . any other enactment . . . regulating the operation of companies incorporated under the Companies and Allied Matters Act' is so broad that it may be construed to extend to the operation of the Investments and Securities Act insofar as it regulates the operation of companies incorporated under the Companies and Allied Matters Act.

However, section 224 of the Investments and Securities Act established the Investments and Securities Tribunal to adjudicate in disputes and controversies arising under the Investments and Securities Act and its Regulations.[195] The Investments and Securities Act actually seeks to confer exclusive jurisdiction on the Tribunal on these matters.[196] In view of the construction earlier placed on section 251(1)(e) of the 1999 Constitution, this provision is of doubtful validity, and the Tribunal will appear to have no jurisdiction in respect of matters relating to securities of companies operating in Nigeria, since the Constitution vests exclusive jurisdiction in such matters in the Federal High Court.[197]

Multilateral Approaches

The globalisation of securities markets has led to an increasing appreciation of the need for crossborder securities regulation. Thus, the Nigerian securities regulatory regime recognises the existence of market operators whose activities are regulated in more than one jurisdiction. Although there has been no specific legislation on this matter, the issues raised have been approached in a number of ways.

The Securities and Exchange Commission is a member of the International Organisation of Securities Commissions. The International Organisation of Securities Commissions comprises of approximately 135 securities regulatory agencies worldwide. Part of its objectives is to further co-operation among members in maintaining just and efficient domestic and international markets through better regulation and to make united efforts in establishing standards and effective surveillance of international

194 Investments and Securities Act, 1999, s 236(1)(d).
195 Investments and Securities Act, 1999, s 234(1) and (2).
196 Investments and Securities Act, 1999, s 242.
197 Okeke, 'One Step Forward, Two Steps Backward: An Examination of the Fate of the New Investments and Securities Tribunal under Nigeria's New Legal Order', (1999) 7 *Journal of International Financial Markets*, at p 308.

securities. The members also seek to assist one another to ensure market integrity by rigorously applying standards and effectively enforcing them.

The International Organisation of Securities Commissions operates by co-operation, with members voluntarily agreeing to implement its resolutions in their respective countries, and progress on issues can be quite slow. Members have some latitude in implementing the resolutions, and the resolutions may have options for alternative courses of action built into them. Furthermore, there is no enforcement procedure for International Organisation of Securities Commissions resolutions and no penalties for non-compliance so that it may take time for regulators to implement the resolutions of the International Organisation of Securities Commissions.

The Securities and Exchange Commission also may work with regulators in other jurisdictions to ensure a proper working of the international securities markets. Although Nigeria lacks specific provisions that empower the Securities and Exchange Commission to invoke its regulatory powers on behalf of foreign regulators, section 8(x) of the Investments and Securities Act authorises the Securities and Exchange Commission to 'liase effectively with the regulators and supervisors of other financial institutions locally and overseas'. This provision may serve as a basis for such co-operation with the regulators of other financial markets.

In furtherance of the above objective, the Securities and Exchange Commission has entered into memoranda of understanding with regulators in other countries, such as China and Ghana. These memoranda of understanding contain arrangements that may help facilitate the resolution of cross-border conflicts. The Nigerian Stock Exchange has similar memoranda of understanding with some foreign exchanges, such as the International Stock Exchange of London, the Egyptian Stock Exchange, the Ghana Stock Exchange, and the Stock Exchange of South Africa.

Unilateral Approaches

Private International Law

Trading in international securities may raise conflict of law issues where the subject matter of the transaction is truly international, as is the case with securities with dual listings, or where the parties are based in different jurisdictions or if, for some other reason, the transaction in question is subject to conflicting laws of two or more jurisdictions. It then becomes necessary to determine the applicable law and the relevant jurisdiction in determining this issue.

Nigeria is a Common Law country and the Common Law rules of private international law determine which country's laws will apply to specific legal relationships that are connected with the laws of other countries. In the context of securities transactions, the applicable rules are those relating to companies and contracts. In applying private international law principles to resolve jurisdictional conflicts, questions may be raised relating to:

- Whether Nigerian courts will determine the dispute in question;
- Which system of law will be applied in resolving the questions of law raised by the dispute; and

- Whether a judgment obtained elsewhere in respect of such disputes will be treated as decisive on the matter and will be enforced by Nigerian courts.

The competence of Nigerian courts to assume jurisdiction over a matter is mainly one of procedure which is dependent on the service of a writ on the defendant. Nigerian courts will assume jurisdiction over a dispute relating to international securities transactions if a writ can be served on the defendant. This is possible if he is present within Nigeria, if he submits to the jurisdiction of Nigerian courts, or if the rules of court authorise service out of jurisdiction.

However, even if a Nigerian court has jurisdiction, it may decline to hear a case and refer it to a foreign court if it decides that the foreign court is the appropriate forum for the trial of the action.[198] This will be the case where the action has a greater or more substantial connection with the law of that country.

Once a Nigerian court accepts jurisdiction over a matter with international aspects, it still needs to decide whether to apply Nigerian law or the law of another jurisdiction. The general rule is that a Nigerian court will apply Nigerian law unless it is established that the law of another country is more appropriate.

Nigerian law will apply if the dispute relates to a company that is sufficiently connected with Nigeria through any of the relevant connecting factors of presence, residence, domicile, or nationality. In contractual transactions, the 'proper law of the contract' will be applied. The proper law is determined by the express choice of the parties, or by judicial determination of the system of law to which the transaction has the closest or most substantial connection or may be inferred from the circumstances of the case.

Nigerian courts will not enforce rights or duties prescribed by foreign law which are contrary to Nigerian public policy. If one of the parties to a transaction has obtained a judgment in respect of the transaction from a foreign court, the issue may arise as to the recognition or enforcement of the judgment by Nigerian courts. This may be done by registration under the Foreign Judgment (Reciprocal Enforcement) Act or by action or counterclaim at Common Law.

Under the Foreign Judgment (Reciprocal Enforcement) Act, foreign judgments are enforceable in Nigeria if substantial reciprocity of treatment is given to judgments of Nigerian courts in the country where the judgment is given.[199] A person who obtains a judgment in a superior court of such a country may apply within six years for registration of such judgment in a superior court in Nigeria. On registration, the judgment may be enforced in Nigeria as if it were the judgment of the court in which it was registered.

198 This is done under the doctrine of the *forum non conveniens*, ie, the Nigerian court is not the appropriate forum in which the action can best be tried in the interest of all the parties and the ends of justice.

199 Foreign Judgment (Reciprocal Enforcement) Act, s 3.

Apart from registration, a foreign judgment may be enforced in Nigeria through the institution of fresh proceedings to enforce that judgment. The foreign judgment creates an obligation on the defendant which is actionable in Nigeria. However, for a Nigerian court to enforce such judgments, the circumstances of the case must have been such as to justify the foreign court in having assumed jurisdiction. The foreign court must have been entitled to summon the defendant and give judgment against him, either because of his presence in the foreign country at the time of the suit or by his submission to the jurisdiction of the court.

Norway

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Norway

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Introduction

Regulatory System

Norway follows a regulatory system similar to that of other Organisation for Economic Co-operation and Development (OECD) countries, and the Norwegian authorities have entered into co-operation agreements with all major international stock exchanges and regulatory authorities. The system in Norway is divided between the Oslo Stock Exchange, which deals with trade-related issues, and the Financial Supervisory Authority (*Kredittilsynet*), which deals with other issues.

The regulatory system is based on current European Union (EU) regulations, which have been implemented in Norway through the European Economic Area (EEA) agreement. The Financial Supervisory Authority and the Stock Exchange also have entered into a co-operation agreement concerning which of the two bodies deals with specific issues. Often, an issue will appear through the market supervision conducted by the Stock Exchange, who will forward a copy of its report to the Banking, Insurance, and Securities Commission for further investigation and possible filing of a criminal complaint with the Serious Fraud Prosecutor.

Neither of the bodies may initiate civil legal actions, which is left to the individuals suffering an economic loss resulting from any breach of current regulations and law. However, the Stock Exchange may impose fines on listed companies and member brokerages.

Legal Sources

The Norwegian Securities Trading Act 1997 is based on the current EU regulations, such as the Investment Services Directive. The Capital Adequacy Directive 2004/39/EC on markets in financial instruments is not yet incorporated in Norwegian law. The Prospectus Directive (2003/71/EC) and the Market Abuse Directive (2003/6/EC) were incorporated in the Securities Trading Act in 2005. Certain issues, particularly relating to trading on the Stock Exchange and prospectuses, are based on the Norwegian Stock Exchange Act 2000 and regulations given based on authority from that Act, particularly the Stock Exchange Regulations. Circulars from the Oslo Stock Exchange and the Norwegian Financial Supervisory Authority are of practical importance.

The Stock Exchange Regulations are to be materially updated in 1998, and this chapter is based on the regulation being updated in accordance with the draft circulated for comments on 14 January 1998.

Authorities

A stock exchange in Norway must be organised as a public limited company. The same applies for authorised market places. Some, but far from all, stock exchange legislation applies correspondingly to authorised market places, eg, the information requirements to the issuers apply correspondingly in an authorised market place. There are two exchanges and one authorised market place in Norway.

The Oslo Stock Exchange is currently the only existing stock exchange in Norway. Income to the Oslo Stock Exchange comes from fees on trades and fees payable from stockbrokers and listed companies. Fees are also payable to the Stock Exchange in connection with all prospectuses issued by listed companies. A managing director heads the administration at the Stock Exchange. There is also a Board of Directors and a Control Committee.

Most resolutions passed by a Norwegian stock exchange can be appealed to an Exchange Appellate Committee appointed by the Ministry of Finance.

The Financial Supervisory Authority is a governmental body under the Ministry of Finance. The Commission has a separate department dealing only with security-related issues, including the granting of brokerage licences.

All listed securities in Norway are subject to registration with a paperless securities register. The Security Central (*Verdipapirsentralen* or VPS) is currently the only existing securities register in Norway. A securities register operates as a 'bank', and each owner must have at least one account with the registry. All trades are settled through the securities register on a 'T-plus-three-days' basis. An accounts-keeper on behalf of investors must have a separate agreement with the Registry, setting out the rights and obligations. Account-keepers, for all practical purposes, will be brokerages and major banks. The investors may wholly or partially mortgage their accounts.

Procedures

As a small economic community, the Norwegian securities industry has been somewhat informal, but this has changed in recent years. This is particularly true as more Norwegian companies have dual listings in other time zones. Thus, the Stock Exchange currently requires that press releases and other information going to the Stock Exchange be forwarded by e-mail rather than by telefax.

A problem for foreigners will normally be that the Financial Supervisory Authority requires that all documents be made available in the Norwegian language or at least duplicated in Norwegian, while the Stock Exchange also accepts the Swedish, Danish, or English languages.

In 2000, the Oslo Stock Exchange adopted a highly advanced electronic market surveillance system.

In 2002, the Oslo Stock Exchange adopted the same trading platform as the other stock exchanges in the Nordic stock exchange alliance, NOREX. As a result of this, several international brokerage firms have joined the Oslo Stock Exchange.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. Currently, the only Stock Exchange in Norway is the Oslo Stock Exchange. Previously, there were smaller stock exchanges in several major cities in Norway.

Basically, no one can own shares representing more than 10 per cent of the share capital or the votes in a Norwegian stock exchange. However, the Finance Ministry may allow a Norwegian or foreign stock exchange to own up to 25 per cent as a part of a strategic co-operation.

All public limited companies which have a licence from the Financial Supervisory Authority to conduct brokerage business and brokerages which, through their domestic licence from an EEA member state, are entitled to conduct domestic business in Norway, may apply to become members of a Norwegian stock exchange. The member must have an adequate capital under the circumstances under which it operates. The Exchange Appellate Committee has interpreted this requirement liberally in a decision concerning a discount broker only operating through the Internet.

Only members of the stock exchange may use the trade system. Thus, only trades that are made by members of the Stock Exchange form the basis for the official quotes of a Norwegian stock exchange.

Transborder Electronic Trading Systems. The NOREX exchanges — being the Oslo Stock Exchange, Stockholm Stock Exchange in Sweden, Copenhagen Stock Exchange in Denmark, Helsinki Stock Exchange in Finland, Iceland Stock Exchange, Tallinn Stock Exchange in Estonia, Riga Stock Exchange in Latvia, and Vilnius Stock Exchange in Lithuania, the *Stockholmsbörsen* in Sweden, the Copenhagen Stock Exchange in Denmark and the Iceland Stock Exchange — use the same trading platform (SAXESS) and have the same member and trading rules.

A member of one of the NOREX exchanges may easily become a member of other NOREX exchanges, by using the existing technical connection and the simplified and harmonised application procedures of NOREX. Apart from this, Norway has no transborder electronic trading system. Access to real-time trading information from the Oslo Stock Exchange can be purchased from a wholly owned subsidiary of the Oslo Stock Exchange.

Securities

National Treatment and Reciprocity. Norway has implemented all current European Community (EC) Directives concerning limited companies and, as a consequence, only public limited companies (*Allmennakstesezskat*, or ASA) may offer their shares to the general public. Only shares issued by public limited companies (*allment aksjeselskap*, or ASA) may have their shares listed.

As a result of Norway having implemented all current EC Directives, including those involving crossborder transactions, securities deriving from an EEA member state may be offered in the same way as set out in the relevant EC Directive. This includes crossborder, local marketing, and use of prospectuses from other EEA countries.

The Oslo Stock Exchange has two lists for shares, ie, the main list and the list for small and medium-sized companies. The difference between the two lists is mainly the requirements with respect to minimum market capitalisation and number of shareholders.

Issuer Requirements. To be listed on the main list, a Norwegian public limited company or a similar foreign company must have a market capitalisation of at least NOK 300 million and normally have at least 25 per cent of its shares spread among at least 500 shareholders, each holding shares worth at least approximately NOK 10,000, excluding shareholders 'linked to the company'.

Furthermore, the company must have existed at least three years and have conducted the major parts of its business activity for at least three years. Accounts must have been published for the last three years, of which one has to be profitable. The board of the stock exchange may grant exemptions from these requirements.

For listing on the list for small and medium-sized businesses, the requirements with respect to market capitalisation is NOK 8 million and the number of non-related shareholders 100. Further, the requirement for profit in one of the recent years does not apply for listing on the list for small and medium-sized businesses.

The board of the Oslo Stock Exchange may decide that a company listed on the small and medium-sized business list with a market capitalisation of at least NOK 300 million for at least one year should be moved to the main list. Similarly, the Board may decide that a company listed on the main list, but whose market capitalisation has been less than NOK 300 million during at least three years, or less than NOK 150 million for one year, should be moved to the small and medium-sized business list.

High growth companies, which normally do not have substantial operating revenues or generate profits, and companies in a pre-commercial phase, must have sufficient liquidity to continue as budgeted for at least 18 months. Other companies must substantiate that they will have sufficient liquidity to continue as budgeted for at least one year. In the case of a merger involving at least one company with listed shares, the merged company must continue to be listed. The same applies in the case of a de-merger or a split of a listed company or in case of transfer of a substantial part of the assets or activities of a listed company.

Securities Requirements. Any type of financial instrument can be listed if the stock exchange in question deems the instruments fit and that they will be traded frequently. The term financial instruments includes:

- Shares and similar instruments;
- Bonds and other transferable debt instruments;
- All other securities, which are normally sold and which give a right to acquire any such transferable security by way of subscription or interchange, or which give a right to a cash settlement;
- Shares in mutual funds;
- Money market instruments;
- Financial futures and forwards contracts;
- Future interest contracts;
- Interest and currency swap contracts and swap contracts in connection with shares and share indexes;
- Options to buy or sell any above-mentioned instrument, including index options, currency and interest options, and similar instruments with cash settlement; and
- Commodity derivatives, ie, financial futures and forwards contracts, options, or swap contracts connected to commodities or services.

Subscription rights in connection with a rights issue of shares in a listed share class will be listed, unless the Stock Exchange finds that such rights do not have general interests, will not be subject to normal trade, or for other reasons should not be listed.

There are other types of rights to demand the issue of shares, including:

- Rights connected to a convertible loan, but transferable independently of transfer of the loan;
- Rights connected to a rights issue, but separated from the subscription right share;
- Subscription warrants;
- Rights to subscribe for subscription warrants or for convertible loans; and
- Other rights to demand the issue of shares, including shares in foreign companies.

These other types of rights to demand the issue of new listed shares can themselves be listed if they are expected to have a general interest and to be traded frequently.

An increasing number of over-the-counter options are cleared through the Norwegian Option Central (NOS) and under its standard guarantee for settlement. This is based on the initiative of the Oslo Stock Exchange as there have been some unfortunate incidents where brokers have issued over-the-counter options without adequately securing settlement by way of encumbering the underlying shares. In cases of bankruptcies among brokers or owners of shares subject to an option, this has led to substantial losses for the counter parties.

Investment firms in Norway must participate in an investment firm insurance fund scheme securing their client's claims in case of insolvency. It is yet unclear to which

extent foreign investment firms providing investment services in Norway will have to participate in the insurance fund scheme.

If options have been registered with the Securities Register and are expected to have a general interest and to be traded frequently, such options may be listed subject to separate applications.

Bonds may be listed if they are expected to have a general interest and will be traded frequently. Listing is subject to application from the bond issuer. The issuer must prepare and publish a bond prospectus, unless the issuer has published an offer prospectus less than three months earlier. The stock exchange may in whole or part be exempt from the prospectus requirement.

Prospectus Requirements. The issuer must prepare a prospectus in connection with:

- Listings, and for listed companies in connection therewith; and
- Issues of securities to which 100 or more persons in the Norwegian market have been invited and which are in excess of €100,000;

There are 10 exceptions to the prospectus requirement for issues of securities.

The requirement as to the content of a prospectus is detailed and follows the normal EC standard.

Corporate Governance. Norwegian public limited companies follow a general three-level hierarchical system with the general meeting as the top body, followed by the board of directors, which is superior to the general manager.

Normally, the general meeting elects the directors. However, if a company with more than 30 employees does not have a corporate assembly, a majority of the employees may demand that a member of the board of directors and an observer with alternates are to be elected by and from among the employees.

If a company with more than 50 employees does not have a corporate assembly, a majority of the employees may demand that up to one-third and at least two of the members of the board of directors with alternates are to be elected by and from among the employees.

In companies having more than 200 employees, an intermediary body called the 'corporate assembly' elects the directors. The general meeting elects two-thirds of the members of the corporate assembly. A third of the members of the corporate assembly and alternate members will be elected by and among the employees. It may be agreed between the company and a majority of the employees, or trade unions representing two-thirds of the employees, that the company is not to have a corporate assembly. If a company has more than 200 employees and it has been agreed that the company is not to have a corporate assembly, the employees will elect a member of the board of directors and an alternate member or two observers with alternates in addition to the representation, which follows from the '50 employees rule' described above.

The general manager has the right and obligation to attend all meetings of the board of directors. The general manager cannot be chairperson of the board of a public limited company or of a private limited company with a share capital of NOK 3,000,000 or more. Only for financial institutions is it required that the general manager automatically be a member of the board of directors.

Registration of Public Offerings. When a prospectus is required, the registration procedures depend on whether the securities are listed. In the case of offers referring to securities, which are quoted on a stock exchange, or for which quotation has been applied for, the prospectus will be sent to the stock exchange for inspection no later than one week before the offer is made. Information as to received notices of offerings is normally available on the web site of the Oslo Stock Exchange on the Internet. The Oslo Stock Exchange requires a fee to be paid in connection with the control of such prospectuses.

In the case of offers referring to securities which are not quoted on a stock exchange and for which quotation has not been applied, the prospectus will be sent to the Register of Business Enterprises for registration before being published.

All prospectuses must be made public no later than the day before the offer can be accepted. This even applies to prospectuses which are relevant only to a narrow circle of investors or security holders. A prospectus must be available free of charge to the public at the offeror's place of business and all places where the acceptance form is published. In addition, an advertisement must be taken out in at least one national newspaper.

When the Prospective Directive implementation Act becomes operative, the registration requirements depend on whether the prospectus is a so-called European Economical Area Prospectus. The European Economical Area (EEA) consists of the European Union countries, Norway, Iceland, and Lichtenstein. A prospectus for an offer equal to or exceeding €2,500,000 is an EEA Prospectus.

Prospectuses which are not EEA Prospectuses must be sent to the Register of Business Enterprises prior to its publishing. EEA Prospectuses do not need to be registered, as they are required to be approved by the Financial Supervisory Authority of Norway or the corresponding prospectus control authority in the EEA member state in question. Furthermore, a prospectus must be published at the latest when the offer period commences.

Registration of Placements. There is no registration of placements with the Oslo Stock Exchange but, before the securities can be issued and transferred to the subscribers the issue must have been registered with the Norwegian Register of Business Enterprises as having been fully paid. Companies who have their share registries kept by the Securities Registries (which includes all listed companies) must register the securities with the Securities Registry, through the accounts-keeper for the listed company.

It is a requirement in Norway that the consideration payable for subscribed shares must have been made prior to issuance, and that the company's auditor must have confirmed its receipt and value in relation to the increase in share capital. Furthermore, the Company

Register must have received all relevant documents, including the auditor's certificate, and must at least have faxed a copy of the company's new company certificate to the accounts-keeper with the securities register. The new shares will then be available on the account of the individual shareholder or his trustee through the securities register the next day.

Registration of Secondary Trade. All secondary trade done through member brokers must be registered with the trade system of the Oslo Stock Exchange the same day the trade takes place if prior to 4:30 pm and before start of trade the next day if after 4:30 pm. The stock exchange opens at 8:15 am, while trading starts at 9 am.

After the trade has been registered with the trading system of the Stock Exchange, it must be registered with the Securities Registry as a transfer between the buyer's and seller's accounts. In this respect, the seller must release the shares from his account pursuant to either a general or specific power of attorney. The trade will then normally be carried out on a 'T-plus-three-days' basis, after which the traded shares will be available on the buyer's account with the Securities Registry.

If the broker has facilities for 'secured transactions', the trade will be reversed electronically and automatically if the buyer or his broker do not have sufficient funds available. This is handled through an electronic link between the Securities Registry and the relevant broker's account with the Central Bank of Norway.

In Norway, investment firms must tape all orders and indications of orders to buy, sell, or subscribe for financial instruments received by telephone. Further, they must store documentation on all orders and indications of orders received through other means of communication for at least three years and keep it searchable.

Periodic Disclosure

Official Trade

All listed companies must have annual accounts, with a directors' report, audited by a chartered auditor. Additionally, listed companies must publish quarterly reports. Quarterly reports, including interim annual accounts, must have been approved by the board of directors of the company within two months after expiration of the relevant period.

The quarterly accounts and the interim annual account must be forwarded to the Stock Exchange immediately after having been adopted by the board of directors. The Stock Exchange will immediately distribute these accounts through its information system. If such information has been received by the Stock Exchange after its opening hours, publication must be made in a safe manner insuring that the information is generally available at the same time for the whole market no later than at the start of trading the next trading day.

Regulated Market

The periodic disclosure regulations apply correspondingly in an authorised market place.

Annual Accounts

Generally, Norwegian limited companies must hold an ordinary general meeting within six months after the end of each financial year, approving the annual accounts and directors' report, including any distribution of dividends. The accounting year in Norway is the calendar year. However, Norwegian branches and subsidiaries of foreign businesses may use the accounting year used by the foreign business.

The annual account must be filed with the Central Accounts Registry within one month of having been adopted by the shareholders' general meeting, ie, normally before 1 August in the year following the accounting year. Filed accounts are publicly available. The Central Accounts Registry delivers copies of filed accounts by mail or facsimile for a nominal fee.

Regulation (EC) 1606/2002 of the European Parliament on the application of international accounting standards is implemented in the Norwegian Accounting Act. Thus, Norwegian-listed companies must prepare their consolidated accounts in conformity with the international accounting standards. Both listed and unlisted Norwegian companies may prepare their company accounts and group accounts in conformity with the international accounting standards, but they are not required to do so.

Foreign Issuers with Primary Listing

For non-Norwegian issuers with primary listing, the requirement for annual and quarterly financial statements will apply. These will be bound pursuant to the terms of the Listing Agreement entered into with the Oslo Stock Exchange. All notices to the Stock Exchange must be made in the Norwegian, Danish, Swedish, or English language.

Foreign Issuers with Secondary Listing

For foreign issuers with secondary listing, the Stock Exchange will normally require an adherence to the same reporting requirements as for Norwegian companies; however, the Stock Exchange will accept other reporting requirements, as long as these are reasonable and in conformity with the requirements of the primary listing.

Any deviation from the standard requirements of the Stock Exchange will be incorporated in the listing agreement entered into with the Stock Exchange. All notices to the Stock Exchange must be made in the Norwegian, Danish, Swedish, or English language.

Issuers with Ongoing Disclosure Duties

Even if an issuer has an ongoing disclosure duty, such as in connection with new information relevant for a correct quote, it will not be exempt from its normal periodic disclosure requirements concerning financial accounts.

Privileged 'Foreign Private' Issuers

Unless an issuer is subject to listing, a foreign issuer in the Norwegian market will not be subject to any disclosure requirements. Prospectus requirements may apply, depending on the circumstances discussed above.

If a 'foreign private' issuer has listed its securities, the periodic disclosure requirements will be found in the listing agreements negotiated on an individual basis. As mentioned above, these requirements will normally conform to any standard and acceptable requirements of the jurisdiction of the issuers' incorporation. This particularly applies if the issuer is listed in its home jurisdiction.

Issuers of Registered Securities

As Norway, for all practical purposes, does not have unregistered securities, there are no specific regulations for issuers of registered securities. The distinction is more between listed and unlisted companies.

American Depositary Receipts Disclosure

Norwegian companies with sponsored American Depositary Receipts programmes comply with the normal Norwegian reporting requirements mentioned above, and any local requirements applicable as a result of requirements of the Securities and Exchange Commission in the United States. As all listed securities in Norway are registered with the Securities Registry, an American Depositary Receipts or custodian arrangement will appear from the transcript from the Securities Registry. Such transcripts are publicly available against a nominal fee covering the actual cost of printing out the transcript.

All custodians must have a licence from the Financial Supervisory Authority, and these are generally granted on a reciprocal basis. If the custodian is subject to regulation by a body similar to the Financial Supervisory Authority with which the Financial Supervisory Authority has disclosure agreements, the licence will normally be granted. As a result, most European banks have or can be accepted as long as their respective regulators or the banks themselves have committed to disclose the identity of the beneficial shareholder to Norwegian authorities on request.

The custodian will find out whether the client is the genuine security owner. If the custodian does not receive information as to the genuine security owner, the custodian must refuse the custody assignment. The custodian will register information for Norwegian tax purposes and for purposes of anti-money laundering measures.

If the company or a public authority so demands, the custodian will be obliged to provide information on who owns the shares covered by the custodian assignment, and on the number of shares owned by each individual shareholder.

If a custodian does not comply with an order to provide Norwegian authorities with required information, the Financial Supervisory Authority may forbid the custodian to have disposal of the securities in his custody.

Proxy Disclosure

There are no periodic disclosures in relation to proxies. The shareholders will be entitled to attend the general meeting, either in person or through a proxy appointed at their own discretion. The right to attend cannot be restricted in the articles of association. The letter of proxy will only apply for the first general meeting unless expressly stated otherwise. The shareholder may revoke the letter of proxy at any time. The articles of association in a public limited company (as opposed to in a private limited company) may stipulate that shareholders wishing to attend the general meeting must give the company prior notice thereof within a fixed deadline, which may not be set earlier than five days prior to the meeting.

The deadline must be stated in the notice convening the general meeting. A shareholder who has not given notice before the expiry of the deadline may be refused access. Generally, proxies must have been received by a Norwegian public company some days prior to the relevant general meeting. This is in order for voting slips to be prepared for the general meeting.

Trading Rules

Securities Offerings

Offer. Regarding prospectus requirements, reference is made to the 'Prospectus Requirements' section above.

Public. Regarding publication of prospectuses, reference is made to the 'Registration of Public Offerings' section above.

Place of Offer. There are no special requirements as to place of offer or acceptance.

Prospectus Control. As the Prospective Directive becomes operative, prospectuses must be approved by the Financial Supervisory Authority or by the corresponding prospectus control authority in the EEA member state in question. If the issuer has its registered office in Norway, the Financial Supervisory Authority approves the prospectus even if the offer is only directed at markets in another EEA state or is only in respect of listing in another EEA state.

For securities which are listed or for which listing has been applied, the draft prospectus must be sent the Stock Exchange for control no later than one week before the offer is made. Announcements and advertisements distributed or made available to the public by the offeror must be approved in advance by the Stock Exchange. The Stock Exchange will decide whether the documents should be controlled before they are made publicly available.

The Stock Exchange may notify the offeror that it has no comments as to the received documents. Such notification does not mean that the Stock Exchange has approved the documents, and it does not stop the Stock Exchange from later disallowing the offer as a

result of the documents including inappropriate information. The Stock Exchange is under an obligation to notify the central Companies Registry if it has refused to accept documents relating to a subscription issue, thus making it impossible for the company to have the share increase registered.

An EEA prospectus that is approved by the prospectus control authorities in another EEA state is regarded as approved in Norway. Regarding registration of prospectuses, reference is made to the 'Registration of Public Offerings' section above.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties. An acquirer of securities listed on a Norwegian stock exchange must notify the stock exchange upon reaching or passing one-twentieth, one-tenth, one-fifth, one-third, one-half, two-thirds, or nine-tenths of the share capital or a corresponding part of the votes of the company. Similar obligations exist when selling down. Securities lending, call options, subscription warrants, other subscription rights, and redelivery of shares after securities lending also count as acquisition, respectively divestment.

The duty to notify exists immediately after agreement concerning acquisition or sale has been entered into. There are concert group definitions. The thresholds apply both for the aggregate holding of the mentioned rights to shares and individually for shares or rights to shares. A shift from forward contracts to shares or vice versa may, therefore, trigger the flagging requirement.

Company Duties. For listed Norwegian companies and other companies whose shares are registered with a securities register, the company's duties are taken care of by the individual investors' account holder towards the securities register or, in the case of new issues, by the account holder for the issuer.

As long as the registration procedures towards the securities register are in place, companies have no obligation as a result of shareholders' acquisition of substantial holdings. An exception to this is the duty of the board of the target company to submit a statement on a mandatory offer, as described under the section 'Procedural Requirements' of the 'Public Take-Over Bids', below.

Insider Trading and Fraud

Basis of Territorial Link. Norwegian law with respect to insider trading applies to 'anyone' with respect to financial instruments which are listed, or for which listings have been applied, with a Norwegian exchange or a Norwegian authorised market or instruments derived from such instruments.

Extraterritorial Application. As long as this requirement is fulfilled, there are no limits on extraterritorial application. Thus, if the Stock Watch of the Oslo Stock Exchange has revealed an illegal trade, it will normally notify Norwegian or foreign police, such as the Serious Fraud Office in the United Kingdom.

Public Take-Over Bids

Territorial Application (Foreign Bidder and Domestic Target). Anyone acquiring more than 40 per cent of the votes in a Norwegian company whose shares are listed on the Stock Exchange must make a mandatory take-over offer. Similar obligations exist for rights to shares which, in effect, transfer the ownership interest, ie, certain options.

International Private Law Aspects. If a voluntary offer has been made, a mandatory offer does not need to be made if the voluntary offer fulfilled the legal requirements of a mandatory offer and the offer document indicated that it should also be regarded as a mandatory offer.

Procedural Requirements. The acquirer must immediately notify the Stock Exchange and the target company. In the notification, it should be stated whether an offer will be made or whether the acquirer will sell down to below the 40 per cent threshold. Such sale must be made within four weeks of passing the threshold.

The offer must be made for all the other shares of the company, including shares with limited or without voting rights. The offer cannot be made subject to conditions, and the offer price must be at least equal to the highest consideration paid by the offeror or agreed in a period of six months prior to the passing of the 40 per cent threshold. If it is clear that the market price at the time of passing the 40 per cent threshold is higher than this, the offer price will be the market price. If the offeror has acquired shares after passing the 40 per cent threshold for a higher price, the offer price will be increased to the later price.

All offers must be made in cash, but the offeror may make alternative offers with non-cash additional alternatives. A financial institution licensed to operate in Norway must guarantee the settlement. Settlement must be guaranteed by a financial institution licensed to operate in Norway. Settlement must take place no later than 14 days after expiration of the offer period. The offer and the offer document must be approved by the Stock Exchange before the offer is made or published. The offer will then be sent by the offeror to all shareholders with known residences and made known to the employees. The target company must co-operate in distributing the offer document.

When an offer is made in accordance with the rules on mandatory offers, the company's board of directors will issue a statement on the offer including information on the employees' views and other factors of significance for assessing whether the shareholders should accept the offer. The board will inform about the views, if any, of the board members and the general manager in their capacity as shareholders in the company.

The statement will be available no later than one week prior to the expiry of the period of the offer. The statement will be sent to the stock exchange, and be made known to the shareholders and the employees. The target company cannot, after it has been notified that an offer will be made:

- Issue any shares or other financial instruments, directly or indirectly, to its subsidiaries;
- Merge directly or indirectly through its subsidiaries;
- Sell or acquire substantial activities directly or indirectly through its subsidiaries;

- Carry out any other dispositions of a substantial nature; or
- Buy or sell any of the shares of the company.

These restrictions do not apply if such actions form part of the ordinary business of the company or in cases where the general meeting has given the board or the general manager authority to pass the resolutions in question with a view to take-over situations.

Exemptions. Worth noticing is the acquirer's possibility of avoiding the mandatory offer by way of selling down below the 40 per cent threshold with four weeks of exceeding it. There are also exemptions for shares held prior to 1 December 1997 (the entering into the force of the regulation) for which a 45 per cent threshold applies. There also are exemptions for shares held prior to a listing.

Recognition of Foreign Take-Over Regulation. If the shares of a company are listed on several stock exchanges, the Norwegian stock exchange may grant exemptions from the take-over regulations.

Jurisdictional Conflicts

Genuine and False Conflicts

The Board of Directors of the Oslo Stock Exchange primarily settles disputes between the administration of the Oslo Stock Exchange and an issuer or other party. Most decisions by the Board of Directors may be appealed to the Stock Exchange Appeal Committee. The Appeal Committee is a body appointed by the Ministry of Finance and headed by a supreme court judge. The chairperson and the deputy chairperson of the Appellate Committee must be legal professionals. The Appeal Committee has its own secretariat within the Ministry of Finance.

If a dispute falls within the jurisdiction of the Financial Supervisory Authority a decision made by the Banking, Insurance, and Securities Commission may be appealed to the Ministry of Finance, and may then be subject to civil legal action.

Multilateral Approaches

Substantive Law Solutions

Harmonisation. As party to the EEA agreement, Norway has adopted all the current EC Directives. The Oslo Stock Exchange and the Financial Supervisory Authority have extensive co-operation agreements with the leading stock exchanges and supervising authorities in the OECD countries.

Recognition. Norway is a signatory to the Lugano Convention concerning civil judgments, and it has several reciprocal bilateral agreements with countries in Europe supplementing the

Lugano Convention. Norway is also a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958).

Procedural Solutions

The Stock Exchange of the Appellate Committee also may function as an arbitration court. Other forms of arbitration also can be agreed, and there are no restrictions with respect to the number of arbitrators or procedural language.

Unilateral Approaches

International Chamber of Commerce (ICC) arbitration is seldom used in Norway because of the costs involved in establishing the court of arbitration. The experience of many, particularly within the field of securities, is that the same arbitrators will appear directly for substantially lower cost than ICC arbitration.

In Norway, few securities law disputes have not been settled amicably. Those disputes, which come before the normal courts, are usually with respect to wrongful settlement and collection, and they mostly involve minor trades and private citizens.

The Philippines

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The Philippines

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Introduction

The fundamental law governing securities offerings in The Philippines is Republic Act Number 8799, the Securities Regulation Code of 2000, under the administration of the Securities and Exchange Commission. Other significant laws and rules are the Implementing Rules and Regulations of the Securities Regulation Code (the 'Rules'), the Corporation Code of The Philippines, the other issuances of the Securities and Exchange Commission, and the rules of the Philippine Stock Exchange.

As the administrative agency entrusted with the duty of implementing the laws and regulations on securities offerings, the Securities and Exchange Commission is vested with the following powers and functions:

- It has jurisdiction and supervision over all corporations, partnerships, and associations which are the grantees of primary franchises and/or a license or permit issued by the government;
- It formulates policies and recommendations on issues concerning the securities market, advises Congress and other government agencies on all aspects of the securities market, and proposes legislation and amendments thereto;
- It approves, rejects, suspends, revokes, and requires amendments to registration statements and registration and licensing applications;
- It regulates, investigates, and supervises the activities of persons to ensure compliance;
- It supervises, monitors, suspends, and takes over the activities of exchanges, clearing agencies, and other similar self-regulating organisations;
- It imposes sanctions for the violation of laws and the rules, regulations, and orders issued pursuant thereto;
- It prepares, approves, amends, and repeals rules, regulations, and orders and issues opinions and provides guidance on and supervises compliance with such rules, regulations, and orders;
- It enlists the aid and support of and/or deputises enforcement agencies of the government, civil or military, as well as private institutions, corporations, firms, associations, and persons in the implementation of its powers and functions under the Code;
- It issues cease and desist orders to prevent fraud or injury to the investing public;

- It punishes for contempt of the Securities and Exchange Commission, both direct and indirect, in accordance with the provisions of and penalties prescribed by the Rules of Court;
- It compels the officers of any registered corporation or association to call meetings of stockholders or members thereof under its supervision;
- It issues *subpoena duces tecum* and summons witnesses to appear in proceedings of the Securities and Exchange Commission and, in appropriate cases, orders the examination, search, and seizure of documents, papers, files and records, tax returns, and books of accounts of entities or persons under investigation, subject to the provisions of law;
- It suspends or revokes, after proper notice and hearing, the franchise or certificate of registration of corporations, partnerships, or associations, on any of the grounds provided by law; and
- It exercises such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to the carrying out of, the express powers granted the Securities and Exchange Commission to achieve the objectives and purposes of these laws.[1]

Public Offerings

In General

Except for certain classes of securities and transactions which are exempt from registration requirements, securities generally cannot be sold or offered for sale or distribution within The Philippines without a registration statement, accompanied by a prospectus and other supporting documents, duly filed and approved by the Securities and Exchange Commission.[2]

If the securities are intended to be listed in the Philippine Stock Exchange, a copy of the registration statement and all other pertinent documents must be simultaneously filed with the Philippine Stock Exchange, in addition to the application for listing. Copies of the application for listing also must be filed with the Securities and Exchange Commission.

If an exemption from registration under section 10.1 of the Securities Regulation Code is available, a notice of exemption must be filed with the Securities and Exchange Commission in the case of a private placement offering or a sale to 'qualified buyers'. Without such notice, a presumption that an exemption is not available may arise and subject the person claiming an exemption to sanctions under the Securities Regulation Code.

Alternatively, an application for confirmation of exemption under section 10.1 of the Securities Regulation Code may be submitted. This confirmation is not required for the validity of the exemption; however, the Securities and Exchange Commission may challenge the exemption at any time and, without such confirmation, the person claiming the exemption has the burden to establish that the same is available. The application for

1 Securities Regulation Code, s 5.
2 Securities Regulation Code, s 8.

confirmation must be filed within 10 days after the sale of the securities concerned, and the corresponding filing fee paid.[3] The filing fee is equivalent to one-tenth of one per cent of the maximum aggregate price or issued value of the securities.[4]

If an exemption is not available, a registration statement and its accompanying documents must be filed with the Securities and Exchange Commission prior to the offering of securities. Within 45 days after the date of filing of the registration statement, or by such later date to which the issuer has consented, the Securities and Exchange Commission will declare the registration statement effective or rejected. An amendment filed prior to the effective date of the registration statement will recommence the 45-day period.

On the registration statement being declared effective by the Securities and Exchange Commission, the sale of the securities subject thereto will be commenced within two business days and be continued until the end of the offering period or until the sale has been terminated by action of the issuer. The registrant may, however, be granted exemption from this requirement on sufficient justification that compliance therewith will defeat its offering objective.[5] On completion or termination of the offering by the issuer, notification of such will be promptly given to the Securities and Exchange Commission. Such notification must include the number of securities sold.

Prospectus Delivery Rule

In General

Securities required to be, and which are, registered pursuant to the Securities Regulation Code will not be sold unless a prospectus, which has been filed with the registration statement in the form and containing the information hereinafter described, is widely disseminated and sufficient copies have been made available so that all who desire may obtain one.

A preliminary prospectus is submitted by a registrant to the Securities and Exchange Commission as part of a registration statement that is not yet rendered effective by the Securities and Exchange Commission. A final prospectus is submitted as part of registration statements rendered effective or recommended to be rendered effective under the Securities Regulation Code. A preliminary prospectus filed with the registration statement required by the Securities Regulation Code may be circulated to potential investors prior to effectiveness of the registration statement if:

- It conforms to the basic registration format provided in the Securities and Exchange Commission and uses the appropriate Securities and Exchange Commission form;

3 Securities Regulation Code, s 8.
4 Securities Regulation Code, r 10.
5 Securities Regulation Code, r 8.1(B).

- It contains the required statement in bold face print, at least 12-point type prominently displayed;[6]
- It is the only selling document utilised in the pre-offering period, with the exception that the information contained in Securities Regulation Code Rule 8.3 (see text, below) may be disseminated, in whole or in part, to summarise the offering;
- Its use is such that wide dissemination is assured;
- Sufficient copies are made available so that all who desire may obtain one; and
- It contains a statement whether the security is being offered in connection with a distribution by the issuer or by a security holder, or both, and whether the issue represents new financing or refunding, or both.[7]

A preliminary or final prospectus will be presumed to have been widely disseminated pursuant to paragraphs 1 and 3 of the Rule if copies have been distributed initially and additional copies have been furnished promptly, on request, to at least the following:

- Each participant in the distribution (e.g., underwriters and brokers);
- The main and extension offices of the Securities and Exchange Commission;
- A stock exchange, if the securities will be listed thereon; and
- More than 20 persons who are not qualified buyers under section 10.1(l) of the Code.[8]

All participants in the distribution of an offering of securities to the public will, when inquiries are made as to the offering, inform interested persons of the availability of preliminary prospectuses and final prospectuses and provide copies if requested. A notice will be placed on the front of the subscription agreement distributed in connection with the offering informing interested persons that they are entitled to receive a copy of a preliminary and/or final prospectus if they so desire and how and where one can be obtained.

Such information about where preliminary and final prospectuses may be obtained must include at least the addresses of extension and main offices of the Securities and Exchange Commission, any exchange wherein the securities may be listed, and that of the issuer company, and the telephone number and the person to be contacted at each such location. A statement also must be made that preliminary prospectuses and final prospectuses are available from all underwriters and brokers participating in the distribution.

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6 The required statement is: 'A registration statement relating to these securities has been filed with the Securities and Exchange Commission, but has not yet been declared effective. No offer to buy the securities can be accepted and no part of the purchase price can be received until the registration statement has become effective, and any such offer may be withdrawn or revoked, without obligation or commitment of any kind, at any time prior to notice of its acceptance given after the effective date. An indication of interest in response hereto involves no obligation or commitment of any kind. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy'.

7 Securities Regulation Code, r 8.1-1(D).

8 Securities Regulation Code, r 8.1(E).

General Prospectus Format

The information required for the registration of any security must include the effect of the securities issue on ownership, including the mix of ownership, ie, foreign and local. The preliminary prospectus filed as part of the registration statement must contain:

- A brief description of the issuer's business and its securities;
- Financial information;
- Information regarding the issuer's management and certain security holders;
- Terms of the offer;
- Shares offered by current stockholders;
- Number of shares outstanding after the offering;
- Proceeds raised by the offering and their use;
- Risk factors;
- Offering price;
- Dilution;
- Dividend policy;
- Distribution plan; and
- Information on underwriter, broker, and dealer compensation.

There also are certain formal guidelines for the prospectus. All information included in the prospectus should be properly captioned or headed to reasonably indicate covered subject matter. The information must be divided into reasonably short paragraphs or sections (with the exception of financial statements and tabular data). Except as to information required in tabular form and financial statements, the information included in the prospectus may be expressed in condensed or summarised form.

Reference may be made to information in other parts of the prospectus instead of repeating the information in the form of notes to the financial statements. Each prospectus used after the effective date of the registration statement must be dated as of the effective date of the prospectus. An amended or revised prospectus used thereafter must bear the date of its issuance. Perhaps most important, all information that is required to be included in the prospectus must be clearly understandable without the necessity of referring to the appropriate Securities and Exchange Commission Form or to the general rules and regulations.

The chief goal of registration is disclosure for the benefit of investors. It thus involves the use of language that can be understood readily by the persons to whom it is addressed. Failure to use language that is clear and understandable to the investor may operate to defeat the purpose of the prospectus.[9]

The notice of filing of the registration statement must be in the prescribed format for publication and must state that a registration statement has been filed with the Securities and Exchange Commission, that the registration statement is open to inspection by interested parties during business hours at the Securities and Exchange Commission, and

9 Securities Regulation Code, r 8.1(I).

that copies of the registration statement will be furnished to everyone who requests such at a reasonable charge. The notice must be published in two newspapers of general circulation in The Philippines once a week for two consecutive weeks. The affidavit of publication must attest that publication of the notification of filing was or will be immediately taken.

Acceptable Documents

Under the Rules, the use of selling documents other than the final prospectus during the offering period is generally prohibited.[10] Likewise, any communication, other than the preliminary prospectus, which constitutes an offer or sale of securities cannot be published or transmitted until after the registration statement is declared effective by the Securities and Exchange Commission. By way of exception, however, the Securities Regulation Code Rules allow the dissemination of documents other than the prospectus, so long as they conform to the guidelines established under Securities Regulation Code, Rule 8.3, as follows:

> Securities Regulation Code, Rule 8.3. Written Communication Not Deemed an Offer for Sale
>
> 1. Any notice, circular, advertisement, letter, or other communication will not be deemed an offer for sale in violation of section 8 of the Securities Regulation Code if it is published or transmitted to any person after a registration statement has been filed and contains any or all of the following information:
>
> a. the name of the issuer of the security;
>
> b. the full title of the security and the amount being offered;
>
> c. a brief indication of the general type of business of the issuer;
>
> d. the price of the security, or if the price is not known, the method of its determination or the probable price range as specified by the issuer or the managing underwriter;
>
> e. in the case of a debt security with a fixed (non-contingent) interest provision, the yield or, if the yield is not known, the probable yield range, as specified by the issuer or the managing underwriter;
>
> f. the name and address of the sender of the communication and the fact that he is participating, or expects to participate, in the distribution of the security;
>
> g. the names of the underwriters;

10 Securities Regulation Code, r 8.1(G).

h. the approximate date on which it is anticipated the proposed sale to the public will commence;

i. whether the security is being offered through rights issued to existing security holders and, if so, the class of securities the holders of which will be entitled to subscribe, the subscription ratio, the actual or proposed record date, the date on which the rights were issued or are expected to be issued, the actual or anticipated date on which they will expire, and the approximate subscription price, or any of the foregoing;

j. with respect to any class of debt securities, any class of convertible debt securities or any class of preferred stock, the security rating or ratings assigned to the class of securities by any credit rating agency recognised or accredited by the Securities and Exchange Commission and the name of such rating agency/ies which assigned such rating/s.

2. Every communication used pursuant to this Rule must contain the following:

a. If a registration statement has not yet become effective, the following statement in bold-face prominent type:

A registration statement relating to these securities has been filed with the Securities and Exchange Commission, but has not yet become effective. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This communication shall not constitute an offer to sell or the solicitation of an offer to buy.

b. A statement whether the security is being offered in connection with a distribution by the issuer or by a security holder, or both, and whether the issue represents new financing or refunding or both;

c. The name and address of a person or persons from whom a written prospectus meeting the requirements of section 12 of the Securities Regulation Code may be obtained.

There are no restrictions on the ability of the underwriter to issue research reports, except that research reports issued prior to the effectiveness of the registration statement must satisfy the foregoing requirements and may not constitute an offer or sale of securities. If the research report includes projections, they must be supported by information from an independent expert.

Exempt Securities

The requirement of registration does not apply to any of the following classes of securities under section 9.1 of the Securities Regulation Code:

(a) Any security issued or guaranteed by the Government of The Philippines, or by any political subdivision or agency thereof, or by any person controlled or supervised by, and acting as an instrumentality of said Government.

> (b) Any security issued or guaranteed by the government of any country with which The Philippines maintains diplomatic relations, or by any state, province or political subdivision thereof on the basis of reciprocity: Provided, That the Securities and Exchange Commission may require compliance with the form and content of disclosures the Securities and Exchange Commission may prescribe.
>
> (c) Certificates issued by a receiver or by a trustee in bankruptcy duly approved by the proper adjudicatory body.
>
> (d) Any security or its derivatives the sale or transfer of which, by law, is under the supervision and regulation of the Office of the Insurance Commission, Housing and Land Use Regulatory Board, or the Bureau of Internal Revenue.
>
> (e) Any security issued by a bank except its own shares of stock.[11]

The Commission may, by rule or regulation after public hearing, add to the foregoing any class of securities if it finds that the enforcement of the Code with respect to such securities is not necessary in the public interest and for the protection of investors. Registration requirements will likewise not apply to the following:

> (a) Any evidence of indebtedness issued by a financial institution licensed by the Central Bank, the Bangko Sentral ng Pilipinas (BSP) to engage in banking/quasi-banking, provided that the purchase and sale of any such security will not be exempt from anti-fraud, civil liability or other provisions of the Code.
>
> (b) Evidence of indebtedness issued to the BSP under its open market and/or rediscounting operations;
>
> (c) Evidence of indebtedness issued to the following primary institutional lenders: banks, including their trust accounts wherein the bank-trustee is granted discretionary powers in the investment disposition of the trust funds, investment houses including their trust accounts wherein the investment houses-trustee is granted discretionary powers in the investment disposition of the trust funds, trust companies, financing companies, investment companies, pre-need companies, non-stock savings and loan associations, building and loan associations, venture capital corporations, insurance companies, government financial institutions, pawnshops, pension and retirement funds approved by the BIR, educational assistance funds established by the national government, and other entities that may be classified as primary institutional lenders by the BSP, in consultation with the Securities and Exchange Commission; provided all such evidence of indebtedness will only be negotiated or assigned to any of the aforementioned primary institutional lenders or the Development Bank of The Philippines with respect to private development banks in relation with their rediscounting privileges; provided further that in case of non-banks without underwriting licenses, such negotiation or assignment will be through banks or non-banks licensed to be an underwriter or a securities dealer; provided finally that in no case will said instrument be negotiated or assigned to non-qualified investors.

11 Securities Regulation Code, s 9.

(d) Bills of exchange arising from a *bona fide* sale of goods and services which are distributed and/or traded by banks or investment houses duly licensed by Securities and Exchange Commission and BSP through an organised market properly conventioned and governed by rules approved by the appropriate regulatory body.

(e) Evidence of indebtedness, such as short or long-term commercial papers, meeting the following conditions:

1. Issued to not more than nineteen (19) non-institutional lenders;

2. Payable to a specific person;

3. Neither negotiable nor assignable and will be held on to maturity; and

4. In an amount not exceeding Fifty Million Pesos (P 50 million) or such higher amount as the Securities and Exchange Commission may prescribe by resolution.[12]

Exempt Transactions

The requirement of registration does not apply to the offering or sale of securities in any of the following transactions under section 10.1 of the Securities Regulation Code:

(a) At any judicial sale, or sale by an executor, administrator, guardian or receiver or trustee in insolvency or bankruptcy.

(b) By or for the account of a pledge holder, or mortgagee or any other similar lien holder selling or offering for sale or delivery in the ordinary course of business and not for the purpose of avoiding the provisions of this Code, to liquidate a *bona fide* debt, a security pledged in good faith as security for such debt.

(c) An isolated transaction in which any security is sold, offered for sale, subscription or delivery by the owner thereof, or by his representative for the owner's account, such sale or offer for sale, subscription or delivery not being made in the course of repeated and successive transactions of a like character by such owner, or on his account by such representative and such owner or representative not being the underwriter of such security.

(d) The distribution by a corporation, actively engaged in the business authorised by its articles of incorporation, of securities to its stockholders or other security holders as a stock dividend or other distribution out of surplus.

(e) The sale of capital stock of a corporation to its own stockholders exclusively, where no commission or other remuneration is paid or given directly or indirectly in connection with the sale of such capital stock.

(f) The issuance of bonds or notes secured by mortgage on real estate or tangible personal property, where the entire mortgage together with all the bonds or notes secured thereby are sold to a single purchaser at a single sale.

12 Securities Regulation Code, r 9.2.

(g) The issue and delivery of any security in exchange for any other security of the same issuer pursuant to a right of conversion entitling the holder of the security surrendered in exchange to make such conversion: Provided, That the security so surrendered has been registered under this Code or was, when sold, exempt from the provisions of this Code, and that the security issued and delivered in exchange, if sold at the conversion price, would at the time of such conversion fall within the class of securities entitled to registration under this Code. On such conversion the par value of the security surrendered in such exchange will be deemed the price at which the securities issued and delivered in such exchange are sold.

(h) Broker's transactions, executed on customer's orders, on any registered Exchange or other trading market.

(i) Subscriptions for shares of the capital stock of a corporation prior to the incorporation thereof or in pursuance of an increase in its authorised capital stock under the Corporation Code, when no expense is incurred, or no commission, compensation or remuneration is paid or given in connection with the sale or disposition of such securities, and only when the purpose for soliciting, giving or taking of such subscriptions is to comply with the requirements of such law as to the percentage of the capital stock of a corporation which should be subscribed before it can be registered and duly incorporated, or its authorised capital increased.

(j) The exchange of securities by the issuer with its existing security holders exclusively, where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange.

(k) The sale of securities by an issuer to fewer than 20 persons in The Philippines during any 12-month period.

(l) The sale of securities to any number of the following qualified buyers:

(i) Bank;

(ii) Registered investment house;

(iii) Insurance company;

(iv) Pension fund or retirement plan maintained by the Government of The Philippines or any political subdivision thereof or managed by a bank or other persons authorised by the Bangko Sentral to engage in trust functions;

(v) Investment company; or

(vi) Such other person as the Securities and Exchange Commission may by rule determine as qualified buyers, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial and business matters, or amount of assets under management.

The Securities and Exchange Commission has issued regulations on who could be considered as qualified buyers under the category cited above. Under the regulations, a qualified buyer is either a 'qualified individual buyer' or a 'qualified institutional buyer', and any individual or institution that intends to be considered as a qualified buyer must register as such with a self-regulatory organisation, such as the Philippine Stock

Exchange, or other entity (such a bank, securities broker, or dealer or investment house) authorised by the Securities and Exchange Commission to maintain a registry of qualified buyers.

Under the regulations, a qualified individual buyer must have the following qualifications at the time of registration as a qualified buyer:

- The buyer must have a minimum annual gross income of P 25 million for at least two years prior to registration; or a total portfolio investment in securities registered with the Securities and Exchange Commission of at least P 10 million or a personal net worth of not less than P 30 million; and
- The buyer has been engaged in securities trading, in his personal capacity or through a fund manager, for a period of one year or has held for at least two years a position of responsibility in any professional or business entity that requires knowledge or expertise in securities trading, such as a legal consultant, financial adviser, sales person, or associated person of a broker-dealer, or a finance, treasury, or trust officer of a bank or other executive position with related responsibilities.

A juridical person will be considered a qualified institutional buyer if it has any of the following qualifications at the time of registration:

- A minimum annual gross income of at least P 100 million for at least two years prior to registration;
- A total portfolio investment in securities registered with the Securities and Exchange Commission of at least P 60 million; or
- A net worth of not less than P 100 million.

The Securities and Exchange Commission may exempt other transactions if it finds that the requirements of registration under the Securities Regulation Code is not necessary in the public interest or for the protection of the investors such as by reason of the small amount involved or the limited character of the public offering.[13]

Any persons claiming exemptive relief under section 10.1 of the Securities Regulation Code must provide to any person to whom they offer for sale or sell securities in reliance on such exemption written disclosure containing the following information:

- The provision of section 10.1 of the Securities Regulation Code under which exemption from registration is claimed;
- Whether the Securities and Exchange Commission's confirmation that such offer and sale qualifies as an exempt transaction has been obtained; and
- The required statement in bold-face, prominent type.[14]

13 Securities Regulation Code, s 10.

14 The required statement is: 'The securities being offered or sold have not been registered with the Securities and Exchange Commission under the securities regulation code. Any future offer or sale thereof is subject to registration requirements under the code unless such offer or sale qualifies as an exempt transaction.'

Exemptive relief under section 10.1(c) of the Securities Regulation Code, with regard to isolated transactions, will not be available to an issuer of securities who will not be considered as an 'owner' thereof. There are special requirements applicable to private placements exemption under section 10.1(k) of the Securities Regulation Code. Securities offered by an issuer to fewer than 20 'non-qualified' buyers in The Philippines during any 12-month period constitutes a private placement offering and is exempt from the registration requirements of the Securities Regulation Code. To effect a valid private placement offering:

- The issuer must file with the Securities and Exchange Commission a notice of exemption from the registration requirements, including therein all pertinent information required to be furnished to the investors, within 10 days after the initiation of any efforts to sell the securities;
- The issuer may not engage in any form of general solicitation or advertising in connection with the offering;
- The securities may only be sold to persons purchasing for their own account;
- Sales may be made to no more than 19 'non-qualified' buyers;[15] and
- The issuer provides any potential buyer with the information required under the Securities Regulation Code, as follows: (a) exact name of the issuer and its predecessor, if any, (b) address of its principal executive offices, (c) place of incorporation, (d) exact title and class of security, (e) par or issue value of the security, (f) number of shares or total amount of securities outstanding as of the end of the issuer's most recent fiscal year, (g) name and address of the transfer agent, (h) nature of the issuer's business, (i) nature of the products or services offered, (j) nature and extent of the issuers' facilities, (k) name of the chief executive officers and members of the board of directors, (l) the issuer's most recent balance sheet and profit and loss and retained earnings statement for each of the two preceding fiscal years or such shorter period as the issuer (including its predecessor) has been in existence, (m) whether the person offering or selling the securities is affiliated, directly or indirectly, with the issuer, (n) whether the offering is being made directly or indirectly on behalf of the issuer, or any director, officer, or person who owns directly or indirectly more than 10 per cent of the outstanding shares of any equity security of the issuer and, if so, the name of such person, (o) the provision of the Securities Regulation Code under which exemption from registration is claimed, (p) whether the Securities and Exchange Commission's confirmation that such offer and sale qualifies as an exempt transaction has been obtained, and (q) the required statement in bold face and prominent type.[16]

15 A corporation, partnership, or other entity will be counted as one buyer; however, if that entity is organised for the specific purpose of acquiring the securities offered and is not a 'qualified buyer' under section 10.1(l) of the Securities Regulation Code, each beneficial owner of equity securities in the entity will count as a separate buyer.

16 The required statement is: 'The securities being offered or sold have not been registered with the Securities and Exchange Commission under the Securities Regulation Code. Any future offer or sale thereof is subject to registration requirements under the code unless such offer or sale qualifies as an exempt transaction'.

If the issuer is a reporting company under section 17 of the Securities Regulation Code, a copy of its most recent annual report may be used to provide any of the required information.[17]

Other Registration Matters

In practice, the duration of the Securities and Exchange Commission's review process varies depending on the completeness of the documents submitted by the issuer and the latter's compliance with the Securities Regulation Code, the Rules, and other requirements issued by the Securities and Exchange Commission.

There are no special rules that differentiate between primary offerings and secondary offerings. Moreover, the liability issues of a seller of securities in a secondary offering are the same as the liability issues of a seller in a primary offering. The settlement process in a public offering is agreed on by the parties and is usually done through the facilities of a bank acting as a paying or settlement agent. Transfers of securities, whether certificated or not, may be validly made and consummated by appropriate book-entries in the securities accounts maintained by securities intermediaries, or in the stock and transfer book held by the corporation or stock transfer agent.

As a matter of policy, securities approved for listing and trading on the Philippine Stock Exchange must be registered and lodged with the Philippine Central Depositary, Inc, a private institution that provides depository and settlement facilities using the book-entry system of recording ownership. The Philippine Stock Exchange has two settlement banks and a clearing house known as the Securities Clearing Corporation of The Philippines through which all transactions are settled. The Securities Clearing Corporation of The Philippines coordinates with the Philippine Central Depositary and the settlement banks to ensure that all obligations necessary for settlement have been met.

Once the Securities Clearing Corporation of The Philippines has confirmed that all obligations have been settled, the transfer of any security from a Philippine Central Depositary participant to another may be effected via book-entry, by debiting one account and crediting another without the need to handle the physical certificates or documents. Stockholders who wish to have physical possession of their stock certificates may request their stockbrokers for the 'upliftment' of their shares from the Philippine Central Depositary and the issuance of stock certificates. For government securities, settlement is done through the Registry of Scriptless Securities.

Offshore Offerings

Offshore offerings of securities are not covered by the registration requirements of the Securities and Exchange Commission, which applies to securities sold or offered for sale or distribution within The Philippines.

17 Securities Regulation Code, r 10.1.

Particular Securities

Exchangeable or Convertible Securities

While the registration requirement under the Securities Regulation Code applies to the offering of exchangeable or convertible securities, the issuance of underlying securities through the following transactions is exempt from the registration requirement:

- In exchange for any other security of the same issuer with its existing security holders exclusively, where no commission or other remuneration is paid or given, directly or indirectly, for soliciting such exchange; or
- In exchange for any other security of the same issuer pursuant to a right of conversion entitling the holder of security to make such conversion, provided that the security so surrendered has been registered or was, when sold, exempt from the registration requirement, and that the security issued in exchange, if sold at the conversion price, would at the time of such conversion fall within the class of securities entitled to registration under the Securities Regulation Code.

As a general rule, only the underlying shares of stock or those which have already been actually converted can be listed on the exchange. However, listing may be permitted if the underlying shares of stock will come from the unissued authorised capital stock of the company.

Warrants

The registration of the warrants must include its underlying shares, and the issuer must disclose in its registration statement the terms of the warrant plan, including computational data relative thereto. Warrant holders may exercise the right granted under a warrant within the period set by the issuer. No extension of the period is allowed.

All registered warrants will be transferable without need of approval from the Securities and Exchange Commission. Non-detachable warrants may be transferred only together with the beneficial securities.

Warrants authorised for issuance by the Securities and Exchange Commission may be listed on an exchange together with the underlying or beneficiary securities. However, the warrants will be automatically de-listed on the lapse of the exercise period. Warrants issued by listed companies are required to be listed.

Options

The registration of the options must include the registration of the underlying shares, none of which will come from the treasury shares of the issuer. The issuer must disclose in its registration statement the terms of the option plan, including computational data relative thereto, and the plan must be submitted as an exhibit to the registration statement. In considering registration of stock options, the Securities and Exchange Commission will be guided by the following:

- Stocks granted to stockholders proportionately with their shareholdings may be allowed;

- Stock options may be granted to employees or officials who are not members of the board subject, however, to a review of the scheme by the board and subject to approval by the stockholders;
- Stock options granted to persons who are not stockholders may be granted only on showing that the board has been duly authorised to grant the same by its charter or by a resolution of the stockholders owning at least two-thirds of all the outstanding capital stock, voting or non-voting, excluding treasury shares; and
- Stock options granted to directors or managing groups and its officers must be approved in a meeting of stockholders owning at least two-thirds of all the outstanding capital stock, voting or non-voting, excluding treasury stock.

Exercise of options must be done within the period set by the issuer and disclosed in its registration statement. All schemes involving the issue or grant of options over shares by listed issuers to, or for the benefit of, executives and/or employees must comply with the Philippine Stock Exchange rules on stock-option plan/stock purchase plan.

Rights Offering

The security to be issued pursuant to a rights offering must be registered with the Securities and Exchange Commission, except when the said security is exempt from registration under section 9 or 10 of the Securities Regulation Code. If the issuer is a listed company, the application for listing of the securities to cover the rights offering and the application for registration with the Securities and Exchange Commission must be filed simultaneously.

When transactions result in the issuance by a listed company of new voting shares to subscribers amounting to at least 10 per cent, but not more than 35 per cent, of the total issued and outstanding capital stock of the issuer through a single or creeping transactions within a period of 12 months from initial disclosure, the Philippine Stock Exchange will generally not permit the listing of the additional shares subscribed by 'related parties' unless stockholder approval is obtained and a rights or public offering is first undertaken. Under Philippine Stock Exchange rules, the following cases are exempt from the rights or public offering requirement:

- The transaction price for the shares is set at a premium over the prevailing market price;[18]
- The requirement for a rights or public offering is waived by a majority vote representing the outstanding shares held by the minority stockholders present or represented in a special meeting of the transaction; and
- Issuers undergoing rehabilitation and bankruptcy will be exempted without prejudice to the provisions of the delisting rules.

18 'Market price' means the weighted average of the closing prices for a period of 30 trading days prior to the transaction.

Underwriting Arrangements

In General

A firm commitment underwriting arrangement and a best-efforts underwriting arrangement are the most common. For initial public offerings, the Securities and Exchange Commission and the Philippine Stock Exchange require a firm commitment underwriting arrangement.

Indemnity

The issuer typically agrees to indemnify each underwriter and its directors, officers, employees, agents, and representatives from all losses, liabilities, claims, damages, costs, and expenses, or actions arising out of an untrue statement or alleged untrue statement of a material fact contained in the registration statement, the prospectus, or any amendment or supplement thereto, or arising out of the omission or alleged omission to state a material fact necessary to make the statements therein not misleading, or arising out of the failure of the issuer to comply with any of its undertakings, covenants, or other obligations under the underwriting agreement, or in connection with the lead underwriter's acceptance or administration of the underwriting agreement or its duties thereunder.

Force Majeure

The typical *force majeure* or 'market out' provisions provide that the underwriter or the issuer may terminate the underwriting agreement on the occurrence of any of the following events:

- Trading at the exchange is closed or suspended for a period of at least three consecutive banking days;
- There is material adverse change in local, national, or international financial, political, economic, or stock market conditions;
- There is a change or impending change in any law, rule, regulation, administrative practice, or interpretation within The Philippines that could materially and adversely affect the financial condition, operations, profitability, or business prospects of the issuer or the ability of an underwriter to perform lawfully its obligations under the underwriting agreement;
- There is a stop order respecting the offering issued by any competent government authority; and
- There is a general banking moratorium in The Philippines.

Success Fees

In The Philippines, a percentage fee is paid to the underwriter, the selling agent, and the issue manager.

Over-Allotment Options

The issuer typically grants the lead underwriter an option, exercisable within the offer period, to purchase and underwrite on a firm basis an additional amount of the security being offered to the public, on the same terms and conditions set forth in the prospectus, solely to cover over-allotments, if any.

The Omnibus Rules and Regulations for Investment Houses and Universal Banks Registered as Underwriters of Securities (the 'Omnibus Rules') provide several requirements. A book-building programme for the domestic market must be undertaken simultaneously with the international tranche, if any. The international tranche may not be sold in the Philippine market except through duly licensed investment houses or universal banks. Only qualified institutional buyers, as defined by the Omnibus Rules, may be allowed to participate in the book-building.

Since the book-building will be done after the registration statement is filed but before it becomes effective, sales, payments, or deposits on subscription and contracts to sell are prohibited. No offer to buy the securities can be accepted and no part of the purchase price can be received until the registration statement has become effective. Such offer may be withdrawn or revoked, without obligation of any kind, at any time prior to notice of its acceptance after the effective date.

In an initial public offering, 30 per cent of the amount of the initial public offering will be made available to qualified institutional buyers under the book-building exercise. This percentage may be adjusted, depending on the reception of the market to the initial public offering. At least 10 per cent of the amount of the initial public offering must be allocated to 'local small investors'. However, the Securities and Exchange Commission may prescribe a different percentage if warranted under prevailing market conditions. The balance of 60 per cent may be distributed directly to the general public or to the clients of underwriters, including institutional investors and high-net-worth individuals.

Underwriting agreements, including the fees to be charged, are subject to the prior approval of the Securities and Exchange Commission. However, in respect of the distribution of exempt securities, duly notarised and executed copies of the underwriting agreements must be submitted to the Securities and Exchange Commission only for its acknowledgement, notation, and reference.

All underwriters must exercise thorough due diligence investigations of all matters relating to the issuer and the issue whether in initial or additional offering to the public to ensure that investors receive complete and accurate material information prior to purchasing shares in the offering. An investment house may not undertake underwriting commitments in an amount exceeding 20 times its net worth and, except in highly meritorious cases as may be approved by the Securities and Exchange Commission, it may not collect underwriting fees in excess of five per cent of the amount generated by the underwriter for the issuer.

Ongoing Reporting Obligations

Continuing reportorial and disclosure provisions of the Securities Regulation Code apply to the following issuers:

- An issuer that has sold a class of its securities pursuant to a registration;[19]
- An issuer with a class of securities listed for trading on an exchange;
- An issuer with assets of at least P 50 million, or such other amount as the Securities and Exchange Commission will prescribe, and having 200 or more holders each holding at least 100 shares of a class of its equity securities;[20] and
- A non-reporting issuer (in connection with a succession by merger, consolidation, exchange of securities, or acquisition of assets) which issues equity securities to holders of equity securities issued by a reporting issuer. The non-reporting issuer will assume the same obligations as the reporting issuer to file reports.

Issuers subject to the reportorial and disclosure requirements must file with the Securities and Exchange Commission:

- An annual report for the fiscal year in which the registration statement was rendered effective by the Securities and Exchange Commission and for each fiscal year thereafter;
- A quarterly report after the end of each of the first three quarters of each fiscal year; and
- A current report, as necessary, to make a full, fair, and accurate disclosure to the public of every material fact or event that occurs, which would reasonably be expected to affect investor decisions in relation to those securities.

In addition, issuers of registered commercial papers must file the following until all the outstanding commercial papers have been paid and such obligation will not be suspended even when the number of holders of the issuer's commercial papers will be reduced to less than 100:

- A monthly report on commercial paper total issuances outstanding as at the end of each month, to be submitted within 10 business days following the end of the reference month; and
- A list of issuances, outstanding balance, and maturing commercial papers as at the end of each quarter.

All corporations whose shares are listed on the Philippine Stock Exchange must furnish the Philippine Stock Exchange with copies of all reportorial requirements submitted to the Securities and Exchange Commission and also must comply with the Disclosure Requirements of the Philippine Stock Exchange.

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19 The obligation of such issuer to file reports will be suspended for any fiscal year after the year such registration became effective if such issuer, as of the first day of any such fiscal year, has less than 100 holders of such class of securities or such other number as the Securities and Exchange Commission will prescribe, and it notifies the Securities and Exchange Commission of such.

20 The obligation of such issuer to file reports will be terminated 90 days after notification to the Securities and Exchange Commission by the issuer that the number of its holders holding at least 100 shares is reduced to less than 100.

Anti-Manipulation Rules

In General

Pursuant to the law's objective to minimise, if not totally eliminate, insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market,[21] the Securities Regulation Code prohibits the following manipulative practices:

- Insider trading;
- Making an untrue statement of a material fact or failing to state any material fact to induce the purchase or sale of a security;
- Creating a false or misleading appearance of active trading in any security;
- Raising or depressing the price of any security to induce the purchase or sale thereof through manipulative devices;
- Engaging in transactions for the purchase and/or sale of any security traded in the exchange for the purpose of pegging, fixing, or stabilising the price of such security, unless otherwise allowed by this Securities Regulation Code or by rules of the Securities and Exchange Commission; and
- Employing any manipulative or deceptive device or contrivance, or executing any short sale or stop-loss order in connection with the purchase or sale of any security in violation of the rules prescribed by the Securities and Exchange Commission.

To enforce these prohibitions, the Securities and Exchange Commission is endowed with a number of powers specified in the law.

Investigatory Power

The Securities and Exchange Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of the Securities Regulation Code, any rule, regulation, or order thereunder, or any rule of an Exchange, registered securities association, clearing agency, or other self-regulatory organisation, and may require or permit any person to file with it a statement in writing, under oath or otherwise, as the Securities and Exchange Commission will determine, as to all facts and circumstances concerning the matter to be investigated.

The Securities and Exchange Commission may publish information concerning any such violations, and to investigate any fact, condition, practice, or matter which it may deem necessary or proper to aid in the enforcement of the provisions of the Securities Regulation Code, in the prescribing of rules and regulations thereunder, or in securing information to serve as a basis for recommending further legislation concerning the matters to which the Securities Regulation Code relates, provided that any person requested or subpoenaed to produce documents or testify in any investigation will simultaneously be notified in writing of the purpose of such investigation, and that all

21 Securities Regulation Code, s 2.

criminal complaints for violations of the Securities Regulation Code, and the implementing rules and regulations enforced or administered by the Securities and Exchange Commission, will be referred to the Department of Justice for preliminary investigation and prosecution before the proper court.

In instances where the law allows independent civil or criminal proceedings of violations arising from the same act, the Securities and Exchange Commission will take appropriate action to implement the same, and the investigation, prosecution, and trial of such cases will be given priority.

For the purpose of any such investigation, or any other proceeding under the Securities Regulation Code, the Securities and Exchange Commission or any officer designated by it is empowered to administer oaths and affirmations, subpoena witnesses, compel attendance, take evidence, require the production of any book, paper, correspondence, memorandum, or other record which the Securities and Exchange Commission deems relevant or material to the inquiry, and to perform such other acts necessary in the conduct of such investigation or proceedings. When it will appear to the Securities and Exchange Commission that any person has engaged, or is about to engage, in any act or practice constituting a violation of any provision of the Securities Regulation Code; any rule, regulation, or order thereunder; or any rule of an Exchange, registered securities association, clearing agency, or other self-regulatory organisation, it may issue an order to such person to desist from committing such act or practice.

The Securities and Exchange Commission may not charge any person with violation of the rules of an Exchange or other self-regulatory organisation unless it appears to the Securities and Exchange Commission that such Exchange or other self-regulatory organisation is unable or unwilling to take action against such person. After finding that such person has engaged in any such act or practice and that there is a reasonable likelihood of continuing, further, or future violations by such person, the Securities and Exchange Commission may issue *ex parte* a cease and desist order for a maximum period of 10 days, enjoining the violation and compelling compliance with such provision.

The Securities and Exchange Commission may transmit such evidence as may be available concerning any violation of any provision of the Securities Regulation Code; or any rule, regulation, or order thereunder; to the Department of Justice, which may institute the appropriate criminal proceedings under the Securities Regulation Code.

Any person who, within his power but without cause, fails or refuses to comply with any lawful order, decision, or subpoena issued by the Securities and Exchange Commission under subsection 53.2 or 53.3 or section 64 of the Securities Regulation Code will, after due notice and hearing, be guilty of contempt of the Securities and Exchange Commission. Such person will be fined in such reasonable amount as the Securities and Exchange Commission may determine or, when such failure or refusal is a clear and open defiance of the Securities and Exchange Commission's order, decision, or subpoena, will be detained under an arrest order issued by the Securities and Exchange Commission until such order, decision, or subpoena is complied with.[22]

22 Securities Regulation Code, s 53.

Administrative Sanctions

The law also grants the Securities and Exchange Commission the power to impose administrative penalties on offending parties if, after due notice and hearing, the Securities and Exchange Commission finds that:

- There is a violation of the Securities Regulation Code, its rules, or its orders;
- A registered broker, dealer, or associated person thereof, has failed reasonably to supervise, with a view to preventing violations, another person subject to supervision who commits any such violation;
- Any registrant or other person has, in a registration statement or in other reports, applications, accounts, records, or documents required by law or rules to be filed with the Securities and Exchange Commission, made any untrue statement of a material fact, or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading; or, in the case of an underwriter, has failed to conduct an inquiry with reasonable diligence to insure that a registration statement is accurate and complete in all material respects; or
- A person has refused to permit lawful examinations into its affairs.

In such cases, the Securities and Exchange Commission will, in its discretion, and subject only to the limitations hereinafter prescribed, impose any or all of the following sanctions as may be appropriate in light of the facts and circumstances:

- Suspend or revoke the registration for the offering of securities;
- Impose a fine of not less than P 10,000 or more than P 1 million, plus not more than P 2,000 for each day of continuing violation;
- In the case of a violation of sections 19.2, 20, 24, 26, and 27, disqualify officers, members of the board of directors, or persons performing similar functions, of an issuer required to file reports under section 17 of the Securities Regulation Code or any other act, rule, or regulation administered by the Securities and Exchange Commission;
- In the case of a violation of section 34, impose a fine of not more than three times the profit gained or loss avoided as a result of the purchase, sale, or communication proscribed by such section; and
- Impose other penalties within the power of the Securities and Exchange Commission.

The imposition of the foregoing administrative sanctions will be without prejudice to the filing of criminal charges against the individuals responsible for the violation. The Securities and Exchange Commission will have the power to issue writs of execution to enforce the provisions of this section and to enforce payment of the fees and other dues collectible under the Securities Regulation Code.[23]

Liabilities and Enforcement

The most common bases of liability for a securities transaction are:

- Filing of a false registration statement;

23 Securities Regulation Code, s 54.

- Violating rules on prospectus, communications, and reports;
- Engaging in fraud in connection with securities transactions;
- Manipulating security prices; and
- Engaging in insider trading.

There are a number of remedial measures available under Philippine law for those who have been victimised by unscrupulous entities. The main mechanisms for seeking remedies and sanctions for improper securities activities, which are cumulative, are:

- Administrative proceedings under sections 54 and 64 of the Securities Regulation Code;
- Civil proceedings on account of false registration statement, violation of rules concerning prospectus, communications, and reports, fraud in connection with securities transactions, manipulation of security prices, violation of rules covering commodity futures contracts and pre-need plans, and insider trading; and
- Criminal proceedings for any violation of the provisions of the Securities Regulation Code or the rules and regulations promulgated by the Securities and Exchange Commission, or for making any untrue statement of material fact in a registration statement or omitting to state any material fact required or necessary to be stated to make the statements therein not misleading.

The penalty for violation of the Securities Regulation Code is a fine of not less than P 950,000 or more than P 95 million, or imprisonment of not less than seven years or more than 21 years, or both, in the discretion of the court. If the offender is a corporation, partnership or association, or other juridical entity, the penalty may in the discretion of the court be imposed on such juridical entity and on the officer or officers of the corporation, partnership, association, or entity responsible for the violation and, if the officer is an alien, he will, in addition to the penalties prescribed, be deported without further proceedings after service of sentence.

Securitisation Act of 2004

Structure

The Securitisation Act of 2004 defines securitisation as a process by which assets are sold on a without-recourse basis by a seller to a special-purpose entity and asset-backed securities (special-purpose entity) are issued by the purpose-purpose entity in accordance with an approved plan, which securities depend, for their payment, on the cash flow of the assets.

Assets that may be sold to a purpose-purpose entity include loans and other financial assets with an expected cash payment stream. Future receivables may be sold to a purpose-purpose entity subject to the Securities and Exchange Commission or the BSP (the Philippine central bank), if the originator is a bank or other BSP-regulated entity. The Act does not cover the securitisation of government receivables arising from royalties, fees, or tax and duties. The transfer of assets to a purpose-purpose entity must be a ‘true sale’ where:

- The assets are legally isolated from the originator or seller and its creditors;

- The special-purpose entity has the right to encumber or dispose of the assets; and
- The transferee receives the profits with respect to the assets, and assumes the risks associated with these assets.

Securitisation must be undertaken pursuant to a Securities and Exchange Commission-approved plan that must include:

- The nature and mechanics of the asset transfer;
- The credit enhancements for the purpose-purpose entity;
- The identities and qualifications of the parties to the transaction;
- The amount, structure, and terms of the purpose-purpose entity;
- A description of the asset pool;
- A description of how the purpose-purpose entity issuer will collect payments on the assets; and
- A plan for the management of the assets.

The purpose-purpose entity must be registered with the Securities and Exchange Commission under the registration requirement of the Securities Regulation Code. Where the class of the purpose-purpose entity to be issued, or the transaction under which they are sold, is exempt from this requirement, the issuer must file a notice of exemption and a disclosure statement with the Securities and Exchange Commission. In all cases, the purpose-purpose entity may be sold only after the Securities and Exchange Commission approves the securitisation plan.

Parties

The Act provides for the qualifications and limitations of the parties. The originator is the original obligee of the assets. The seller is the entity that conveys the assets to a purpose-purpose entity. Neither entities nor their affiliates may provide credit enhancements for the purpose-purpose entity. The purpose-purpose entity must be created and operated solely for securitisation. It can be a stock corporation or a trust administered by a BSP-licensed trust entity.

The activities of a purpose-purpose entity are restricted to those contained in the securitisation plan, although it can engage in other activities with the approval of the Securities and Exchange Commission and holders representing at least two-thirds of the outstanding amount of the purpose-purpose entity.

The servicer is the entity designated by a purpose-purpose entity to collect payments on the assets. It must be a stock corporation with a minimum capitalisation of P 10 million. It may not share common ownership, officers, or directors with the purpose-purpose entity, and it cannot function as the manager of the assets. The originator or seller can act as servicer only with the approval of the Securities and Exchange Commission or the BSP, in certain cases.

The Act contemplates the creation of secondary mortgage institutions to provide liquidity to primary mortgage lenders and to develop a secondary market for a housing-related purpose-purpose entity. For this purpose, these institutions may:

- Purchase, on a wholesale basis, residential mortgages and housing-related receivables;

- Buy and sell residential mortgages and housing-related purpose-purpose entities; and
- Provide loans to primary lending institutions secured by residential mortgages.

Incentives

Any yield from a purpose-purpose entity is subject to a 20 per cent final withholding tax, except a purpose-purpose entity held by tax-exempt investors. However, to encourage the securitisation of housing-related receivables of government housing agencies, any yield or income of investors from socialised housing-related purpose-purpose entities is exempted from income tax.

The transfer of assets and related security interests to a purpose-purpose entity is exempted from value-added tax and documentary stamp tax or other taxes imposed to replace value-added tax. Except for registration fees payable to the Securities and Exchange Commission, all registration and annotation fees in connection with the transfer of assets will be 50 per cent of the applicable fees. The transfer of assets (in the form of lands or buildings) by an obligor to a purpose-purpose entity (in satisfaction of such obligor's money debt to the purpose-purpose entity) is exempted from capital gains tax.

The original issuance of a purpose-purpose entity and other securities related to the securitisation is exempted from value-added tax or other tax imposed in lieu of value-added tax. All sales or transfers of a purpose-purpose entity and related credit enhancements in the secondary market are exempted from documentary stamp tax and value-added tax or other taxes imposed to replace them. The foregoing benefits provided to transactions entered into by a purpose-purpose entity also are granted to the same transactions entered into by a secondary mortgage institution.

Portugal

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Portugal

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Introduction

Regulatory System

The first Securities Market Code[1] established the Markets and Securities Commission (CMVM), a public agency, independent at both administrative and financial levels, granting it regulatory and supervisory powers previously held by the government. A second major reform was carried out in 1999 with the enactment of the Securities Code,[2] which has been in force since 1 March 2000.

In 2004, the Securities Code was revised to promote the competitiveness of the Portuguese securities markets at an international level. The Securities Code has been subject to major reorganisations as a consequence of the Portuguese implementation of European Union (EU) legislation.

Legal Sources

The Securities Code embodies the main rules of securities regulation and provides legal support for the enactment of other regulatory instruments. This set of rules is complemented by the enactment of the CMVM Regulations (*Regulamentos*), Instructions (*Instruções*), and Ministerial Decrees (*Portarias*). The CMVM also issues general 'soft law' instruments, such as recommendations and assessments. Other relevant legal instruments regulating the Portuguese securities markets include:

- The particular legal instrument regulating each type of securities;
- The Companies Code (*Código das Sociedades Comerciais*, CSC), approved by Decree-Law Number 262/86, of 2 September, as amended;
- The General Framework on Credit Institutions and Financial Companies (*Regime Geral das Instituições de Crédito e das Sociedades Financeiras*), approved by Decree-Law Number 298/92, of 31 December, as amended; and

1 Decree-Law Number 142-A/91, of 10 April.
2 Decree-Law Number 486/99, of 13 November, as last amended by Decree-Law Number 40/2014, of 18 March.

- The access to insurance activity, approved by Decree-Law Number 94-B/98, of 17 April, as amended.[3]

Authorities

The Ministry of Finance (*Ministério das Finanças*) defines the policies relating to the securities markets, exercises administrative supervision over the CMVM, and coordinates securities supervision and regulation between public authorities.

The CMVM is responsible for regulating and exercising supervision of the securities markets, public offerings of securities, settlement systems, and central securities systems.

Without prejudice to the competence granted to other authorities, the following entities are supervised by the CMVM in relation to activities involving securities:

- Management entities of regulated markets, MTFs, settlement systems, clearing houses, central securities depositories, and central counterparties;
- Financial intermediaries and investment advisers;
- Issuers of securities;
- Qualified investors and holders of qualifying holdings;
- Guarantee funds and investor compensation schemes and their respective managing entities;
- Auditors and rating agencies, registered with the CMVM;
- Securitisation firms;
- Venture capital firms;
- Entities proposing to enter into or mediate insurance agreements linked to investment funds or to market individual agreements to open-ended pension funds, under such activities;
- Holders of short positions on relevant shares and sovereign debt and acquirers of protection in sovereign credit default using swaps;
- Other persons whose main or secondary activity relates to the issue, distribution, trading, registration, or deposit of financial instruments or, generally, with the organisation and functioning of the markets in financial instruments.

The CMVM has jurisdiction to supervise foreign entities exercising cross-border activities to the extent that such activities have some relevant connection to markets, operations, or securities subject to Portuguese law.

3 The Securities Code, as well as some complementary legislation, is available in English on the CMVM's website (http://www.cmvm.pt). It is stressed that this translation is for information purposes only and bears no legal value, and therefore it should not be the basis for any legal assessment or deemed as replacing proper legal advice.

The CMVM's supervisory duties also include prudential supervision over operators of markets, settlement systems, central securities systems, central counterparties, collective investment funds, and the operators of guarantee funds and investor compensation schemes. This prudential supervision seeks the preservation of the solvency and liquidity of the institutions, prevention of systemic risk, and control of ethical standards of members of management bodies and holders of qualifying participations.

The Bank of Portugal (*Banco de Portugal*) oversees the banking sector, regulating and supervising all credit institutions and investment companies (ie, most of the financial intermediaries operating in the securities markets), officially acknowledges monetary securities (ie, short-term debt securities), regulates and manages the settlement systems, and acts as lender of last resort. The Portuguese Insurance Institute (*Instituto de Seguros de Portugal*) regulates and supervises insurance, reinsurance, pension funds activities, and insurance intermediation.

Portuguese Markets

In General

Since 1 November 2007, investment orders can be executed not only in regulated markets (formerly designated as exchanges) but also within multilateral negotiation systems and systematic internalisation schemes. Financial intermediaries can promote the matching of their own financial instrument portfolio with orders submitted by their clients within a systematic, organised, and frequent framework but out of any regulated market or multilateral negotiation systems. This procedure is designated by the Securities Code as a systemic internalisation and is regulated by EC Commission Regulation 1287/2006, which is directly applicable in Portugal.

Multilateral negotiation systems are subject to the rules applicable to regulated markets on registration, securities admission, membership, operation, and supervision powers but, unlike such markets, they do not necessarily operate on a regular basis and can either be managed by regulated market operators or by financial intermediaries which are registered with the CMVM.

The opening of a regulated market is subject to government authorisation, at the operator's request and following consultation with the CMVM. The list of regulated markets operating in Portugal is conveyed to the European Securities and Markets Authority and to all EU Member States and available at the regulator's website. The regulated markets operating in Portugal are:

- Eurolist by Euronext Lisbon (*Mercado de Cotações Oficiais*), the official quotations market managed by Euronext Lisbon — *Sociedade Gestora de Mercados Regulamentados*, S.A.;
- Futures and options market (*Mercado de Futuros e Opções*), managed by Euronext Lisbon — *Sociedade Gestora de Mercados Regulamentados*, S.A.;

- Special Public Debt Market (*Mercado Especial de Dívida Pública*, MEDIP), managed by MTS Portugal — *Sociedade Gestora do Mercado Especial de Dívida Pública, SGMR*, S.A.; and
- Energy Commodities Market (*Mercado Ibérico de Electricidade*, MIBEL), managed by OMIP — Pólo Português, *Sociedade Gestora de Mercados Regulamentados*, S.A.

Operational Rules and Membership

The operating rules of regulated markets are set out by each operating entity and are subject to prior registration with the CMVM. Operators of regulated markets located or operating in Portugal should agree among themselves as to any informative or operative connections necessary for the proper functioning of the markets they manage and for the protection of the interests of investors. Operators of regulated markets located or operating in Portugal may enter into agreements with similar entities in other states, which ensure that securities listed on any of the relevant markets are also admitted to trading on the other markets or that members of one regulated market are permitted to participate in another market. Such agreements are no longer subject to registration, although the CMVM may oppose its execution if the regulated market located or functioning in a foreign state does not impose requirements similar to those of the regulated market located or operating in Portugal.

Regulated markets function by means of public sessions, which may be ordinary or extraordinary. Ordinary regulated market sessions are held at the time and on the days defined by the regulated market operator, for regular trading. Extraordinary sessions take place as a result of a judicial decision or a decision made by the regulated market operator, at the request of specific interested parties.

Following the implementation of the MiFID Directive, membership in a regulated market is not limited to financial intermediaries. Any entities that evidence to be professionally apt and have adequate negotiation capacity, organisation method, and financial resources can be admitted as members of a regulated market. The operator of the market will have responsibility for the admission of market members, in accordance with the principles of equality and respect for the rules of healthy and fair competition. Regulated market members who merely exercise trading functions may only be admitted after having entered into an agreement with one or more of the members which guarantee settlement of transactions carried out by them.

Admission Requirements and Procedures

The admission of securities to a specified regulated market is determined by each operator. However, the Securities Code imposes minimum requirements with regard to admission to trading on the official quotations market regarding both the issuer and the securities issued.

As a general rule, the issuer must show conformity with the law to which it is subject, with regards to both its incorporation and operation, and demonstrate

that its financial and economic situation is compatible with the nature of the securities to be admitted and with the market on which listing is being requested.

Nevertheless, only issuers that, in addition to these requirements, have been conducting their business for at least three years and have published their annual financial statements in accordance with the applicable law for the three preceding financial years can apply for official listing of securities.

Any fungible, assignable, unencumbered securities or other financial instruments enabling an orderly price formation are eligible to be admitted to trading on a regulated market to the extent that they have been issued in conformity with the issuer's statutory law and the respective content and form of representation complies with the applicable law.

Once they have been admitted to a regulated market, securities may be subsequently traded on other regulated markets without the need of the relevant issuer's consent or further information provision (although notice will be provided to the relevant issuer). The listing of each type of securities entails additional requirements, such as:

- Shares must evidence an adequate level of public dispersal ascertainable at admission and forecasted market capitalisation of at least €1 million or (alternatively, if the capitalisation criteria cannot be ascertained) own capital, including the results of the previous financial year, amounting to at least €1 million;
- The amount of the loan represented by a bond financing cannot fall below €200,000; and
- The admission of convertible securities entitling the holder to subscribe for shares is conditional on the previous or simultaneous admission to trading of the underlying securities (this requirement may be waived by the CMVM if so permitted by the personal law governing the issuer, should the issuer demonstrate that the holders of the relevant securities possess the necessary information to make a reasonable assessment of the value of the shares into which the bonds are convertible).[4]

When the securities are subject to a foreign law (with the obvious exception of all EU Member States), the CMVM may require a legal opinion confirming compliance with the aforementioned requirements.

The admission of securities subject to the governing law of any EU member state may not be conditioned on previous admission to a regulated market operating in such state. The application for admission to trading on a regulated market must be filed with the respective operator by:

- The issuer;

4 If the underlying securities are already admitted to trading on a regulated market located or operating in an EU Member State where the issuer has its head office, admission to listing will involve prior consultation of the authorities of the relevant member state.

- The holders of at least 10 per cent of issued securities belonging to the same category; or
- The Agency for Exchequer and Public Debt Management (*Agência de Gestão da Tesouraria e da Dívida Pública* — IGCP, E. P. E.) if the securities in question are bonds issued by the Portuguese State, together with the necessary information and documentation required to prove that all the above referred requirements have been met.

Applications can be submitted before such requirements are met, provided that the issuer indicates how and when these will be met. The operator must provide the CMVM with a copy of the admission application, as well as with any documents necessary for the approval of the admission prospectus. The application for listing must include reference to the means by which the issuer is to disclose information to the public, the identification of the member of the settlement system approved by the market operator through which the payment of the rights (conferred by the securities to be admitted) is guaranteed, and the designation of an attorney to represent the issuer before the market and the CMVM.

Notice of approval or denial of the application must be served by the operator to the applicant within 90 days and subsequently to the CMVM, identifying the securities admitted, describing their characteristics and the means of accessing the prospectus. Admission to trading on a regulated market can only be denied where there is a confirmed:

- Non-fulfilment of the requisites set by law, regulations, or rules of the respective market;
- Non-fulfilment by the issuer of duties to which it is subject in other markets, located or operating in Portugal or abroad, where the securities in question are listed; or
- Admission to trading not being advisable in the investors' interest, based on the issuer's situation.

Admission Prospectus

Prior to the admission of securities to trading, the issuer must publish (either (i) in a major newspaper or (ii) by means of providing copies at the registered office or website of the issuer, the branches or websites of the relevant financial intermediaries, and the registered office or website of the operator of the market where the securities are to be listed or, finally, (iii) in the CMVM website) a prospectus approved by the CMVM or by the competent authority of another member state, in line with the criteria described below applicable to the offer prospectus.

The Securities Code foresees some admission prospectus exemptions in relation to certain types of securities, which include, among others, non-equity securities issued or unconditionally guaranteed by a member state (including regional or local authorities), member state Central Banks, public international entities, associations with legal status or non-profit-making bodies recognised by a

member state; securities where the total consideration of the offer is less than €5 million (limit calculated over a 12-month period) and provided certain conditions are met; shares securities offered, allotted, or to be allotted free of charge to existing shareholders or to former directors or employees by their employer, by a company in a control or group relation, or by a company subject to joint control; and securities already admitted to trading on another regulated market.

The admission prospectus may, in whole or in part, be written in a language (other than Portuguese) currently used in the international financial markets if:

- The securities to be listed have a nominal value equal to or over €100,000 or, in cases where the securities do not have a nominal value, where the unitary subscription or sale price is equal to or over such value;
- The listing was directed to markets in several different states;
- The issuer is not domiciled in Portugal; or
- It is destined for a market or market segment which, due to its characteristics, is only accessible to institutional investors.[5]

The form and contents of the prospectus, as well as the responsibility for its contents, are very similar to those outlined below in relation to the public offers prospectus.

Information Disclosure Duties

The information to be compulsorily disclosed under the rules described below must be disclosed at least through a specific broad access communication channel, ie, the CMVM Information Disclosure System (*Sistema de Difusão de Informação*).[6]

Additionally, issuers of securities admitted to a regulated market must release such data on their corporate website for at least one year counted as from such mandatory disclosure. The CMVM may require defaulting entities to provide the missing or incomplete information and publish it at their expense.

In some cases, it also may waive the disclosure of information whenever the relevant release is contrary to public interest and likely to cause damages to the issuer, provided that the non-disclosure does not lead to a deficient evaluation of the relevant securities by the investor.

Compliance with these requirements must be made in Portuguese, or certified Portuguese translations of the relevant documents must be submitted, unless otherwise waived by the CMVM.

5 The CMVM may, however, require a summary in Portuguese that describes the offering and the risk factors.
6 See http://www.cmvm.pt.

Periodic Disclosure Requirements

The following issuers of securities must submit to the CMVM an extensive list of periodic information relating mainly to economic and financial data:

- Issuers of securities with a nominal value of less than €1,000 if such securities are admitted to trading on a regulated market operating in Portugal or other EU member state, when such issuers are subject to Portuguese *lex personalis*[7] or are exclusively admitted to trading on a regulated market operating in Portugal, when such issuers are subject to an EU member state *lex personalis*; and
- Issuers subject to a *lex personalis* other than that of an EU member state of securities with a nominal value of less than €1,000 if such securities are admitted to trading on a regulated market operating in Portugal or other EU member state and the CMVM is designated as the competent authority to supervise the relevant disclosure.

The issuers identified above must publish and make available to the public for a five-year period the following documentation:

- Within four months as of the end of the financial year, the management report, annual accounts, the legal certificate of accounts, and other accounting documents required by law or regulation even if such documents have not yet been approved by the issuer's general shareholders' meeting, the list of qualified holdings, and the entire text of a report of an auditor registered with the CMVM (which should include an opinion relating to growth forecasts for the business and the financial and economic situation of the issuer and elements corresponding to the legal certification of accounts, if not required by another legal rule or if not drawn up by an auditor registered with the CMVM); and
- Within two months as of the end of the first semester of the financial year, half-year information relating to the activity and results of such semester, including the list of qualified holdings, the condensed financial demonstrations, a half-year management report, a list of securities issued by the company or the issuer group, and a description of material-related parties' transactions if share issuers are concerned.

In each case, the documentation set must include an officers' certificate (identifying the name and status of each officer) confirming that, to the best of the officers' knowledge, the disclosed information was prepared in accordance with the applicable accounting principles, providing a truthful and appropriate description of the issuers' financial condition and that the management report adequately describes such issuer's business evolution and forecasts and includes a risk factor identification. The documentation in such cases must also include:

- Quarterly information relating to operations, profit/loss situation, and economic and financial situation where the issuers subject to Portuguese *lex*

7 In practice, the issuers which are subject to Portuguese *lex personalis* are companies with registered head office in Portugal.

personalis exceed, for two consecutive years, two of the following three limits: (a) a €100 million balance sheet, (b) €150 million profits, and (c) 150 workers;[8] and

- An annual statement summarising the information made available to the public in the preceding year under the mandatory disclosure provisions, including detailed information on the source of such requirements.

Issuers that are Member States (or regional or municipal authorities) or Central Banks, as well as issuers of debt securities with a nominal value exceeding € 100,000, are exempt from the above-mentioned disclosure duties. Other data which triggers disclosure obligations includes:

- Amendments to the company's by-laws (which must be notified to the CMVM and the relevant regulated market operator(s) before their approval);
- Issue of securities;
- Amendments to any right inherent to the respective issued securities;
- Acquisition or disposal of own shares, whenever as a result thereof the proportion of same exceeds or falls below the thresholds of 5% and 10%;
- Approval of annual accounts by the general shareholders' meetings;
- Calling of general meetings;
- Attribution and payment or exercise of any rights conferred by listed securities or by the shares to which these give the right to;
- Modification of the rights of bondholders which result, specifically, from changes to the conditions of the loan or to the interest rate; and
- Issue of other shares and of other bonds, with an indication of the beneficial privileges and guarantees associated with them.

There is a duty of managers of issuing companies admitted to trading on a regulated market (and on any persons closely related to such managers, as defined under the Securities Code) to disclose to the CMVM acquisitions of a company's shareholding exceeding €5,000, or of any securities related to such company entered into on their behalf, on behalf of third parties or of third parties on the former's behalf within five business days after reaching the €5,000 threshold.

Corporate Governance Disclosure Requirements

The corporate governance disclosure requirements reflect European and Organisation for Economic Cooperation and Development (OECD)

8 Issuers that do not meet these requirements have nonetheless to release each semester management board declarations, including a description of material transactions affecting such issuer's financial condition as well as of the company's half-year business performance.

recommendations, particularly in the context of the Takeover Directive implementation.

The CMVM has regulated on these specific disclosure duties[9] and published a Corporate Governance Code. Issuers of shares admitted to trading on a regulated market must include in their annual management report the following detailed information:

- Share capital structure (including the identification of shares which are not admitted to trading, with an indication of the different classes of shares and, in relation to each share class, identification of the rights and obligations attaching to it, and the percentage of share capital represented by each class);
- Share transfer restrictions, such as disposal consents clauses or restrictions on the ownership of shares;
- Qualified holdings in the issuer's share capital;
- Identification of any shareholders that hold special rights and description of such rights;
- Control mechanisms of eventual employee share schemes when the voting rights are not directly exercised by the employees;
- Voting rights restrictions, such as limitations on the voting rights of the holders of a given percentage or number of votes, deadlines for exercising voting rights, or systems whereby the financial rights incorporated in the securities are detached from such securities;
- Shareholders' agreements acknowledged by the company and which may result in restrictions on the transfer of securities or voting rights;
- Rules governing the appointment and replacement of board members and amendment of the articles of association;
- Powers of the board, notably in respect of resolutions to increase equity;
- Significant agreements to which the company is a party and which take effect, are modified, or terminate on a change of control of the company following a takeover bid, as well as the effects thereof, except where their nature is such that this disclosure would be seriously harmful to the issuer (this exception not applying where the company is specifically obliged to disclose such information on the basis of other legal requirements);
- Agreements between the company and its board members or employees providing for compensation on resignation, dismissal without valid reason, or redundancy of such entities following a takeover bid;
- Implemented internal control and risk-management systems with regard to financial information disclosure;
- Declaration detailing the aspects of the Corporate Governance Code which are and which are not being complied with and grounds for any non-compliance, to the extent applicable;

9 Originally through CMVM Regulation Number 1/2007, which has since been repealed by CMVM Regulation Number 1/2010.

- Identification of the location where applicable corporate governance reports are made available to the public;
- Description of the composition and operation of the company's corporate bodies, as well as of any commissions created within such corporate bodies; and
- Remuneration policy of the management corporate body, including the individual and aggregate annual wage amount perceived by its members.

Issuers of securities other than shares admitted to trading on a regulated market operating in Portugal also are subject to some of the corporate governance requirements listed above, but the list of data to be disclosed can be less stringent.

The issuers of shares admitted to trading on a regulated market which are companies subject to Portuguese *lex personalis* are further required to publish a detailed report on their corporate governance structure and practices, in accordance with a specified standard model approved by the CMVM. The report must specifically identify the CMVM's recommendations on corporate governance that are complied with and those that are not. All recommendations that are not fully adopted are understood not to be complied with.

Additional stringent information obligations are imposed on these particular issuers, with a view to ensure a permanent contact with the market with respect to the shareholders' equality and to avoid investor information asymmetries. These include the obligations to:

- Create an investor assistance service;
- Submit to the CMVM information relating to plans for the allotment of shares and/or stock options to employees and/or members of the board of directors during the seven days following the respective approval; and
- Make available an easily accessible website in clearly identified terms, and updated with information including the corporate statutory data, the identity of the office-holders of corporate bodies and the market liaison representative, financial reports (accessible for at least five years), a semester calendar of company events (including general meetings, disclosure of annual, half-yearly and, if applicable, quarterly financial reports), calls and proposals presented for discussion, and voting in the general shareholders' meeting.

Privileged (Qualified) Information

Issuers of shares admitted to trading on a regulated market must immediately disclose any privileged information (as well as any changes to information disclosed as such), which is defined as any information that:

- Directly concerns the issuing company or the securities issued by such company;
- Has a precise nature (including past and present data as well as future facts to the extent that such facts are predictable);

- Is not public; and
- Would affect the price of the same if it were made public (ie, price sensitive in light of the judgment of a reasonable investor).

Issuers must keep (for a five-year period) an updated list with all persons that have access to privileged information. Issuers may elect to postpone the disclosure of such privileged information to the extent that such disclosure would prejudice their legitimate interests (as in the case of a material negotiation procedure requiring a certain degree of secrecy) provided that the disclosure postponement does not have a misleading effect on the public and the issuer ensures the confidentiality of the information until its disclosure. For this purpose, the Securities Code sets out the minimum procedures which must be adopted to guarantee that the confidentiality is preserved and that the information is immediately disclosed following confidentiality breach.

Disclosure of Qualified Holdings Acquisition in Public Companies

Each time a shareholder reaches or exceeds a holding of 10 per cent, 20 per cent, one-third, 50 per cent, two-thirds, and 90 per cent of the voting rights in the share capital of a public company[10] subject to Portuguese *lex personalis* (or decreases such holding to any of those limits), it must, within four trading days (days on which the relevant regulated market is open for trading) after the occurrence of such fact, inform:

- The CMVM and the company to which such voting rights pertain; and
- The entities referred to above of those situations that determine the attribution to the shareholder of voting rights inherent to securities belonging to third parties.

A public company must immediately publish any disclosure communication received in this context by making it available at the CMVM Information

10 The Securities Code sets up a specific public company concept (*Sociedade Aberta*), defined as a company whose share capital is dispersed among the general public and that has been incorporated through an initial public subscription offering specifically addressed at individuals or entities resident or established in Portugal, which issues shares or other securities that grant the right to subscribe or to acquire shares that have been the object of a public subscription offer specifically addressed at individuals or entities resident or established in Portugal; issues shares (or other securities that grant the right to their subscription or acquisition) that are or have been listed on a regulated market situated or operating in Portugal; issues shares that have been sold by public offer of sale or exchange in a quantity greater than 10 per cent of the company's share capital directed specifically to individuals or entities resident or established in Portugal; or has been incorporated as the result of the de-merger of a public company or a company that incorporates, through merger, all or part of its assets. The status of a public company must be mentioned in all its external acts. The most significant implication of such status (other than the duty to disclose qualified shareholdings) is the possibility of being subject to mandatory takeovers (which are only applicable to public companies).

Disclosure System. Together with the shares or voting rights held, the Securities Code also deems attributed to the relevant holder those rights:

- Held by third parties in their own name, but on behalf of the relevant holder, a company with which the relevant holder is in a control position, holders of voting rights with whom the relevant holder has entered into a voting agreement except if, by virtue of this same agreement, the relevant holder is bound to follow a third party's instructions and, if the relevant holder is a company, by members of its management and statutory audit boards;
- That the relevant holder can acquire pursuant to an agreement executed with the respective shareholders;
- Held by persons that have entered into any agreement with a shareholder aimed at either acquiring control of the company or frustrating any changes to its control or otherwise constituting an instrument of concerted exercise of influence over the company in which they own shares;
- Attached to shares granted and held as security in favour of the relevant holder or administered by or deposited with the relevant holder, if the voting rights have been attributed to the relevant holder or if discretionary powers for their exercise have been granted to the relevant holder; and
- Attributable to any person or entity referred to in one of the previous paragraphs by application, with due adaptations, of the criteria referred to in any of the foregoing bullets.

Accordingly, shareholder agreements that aim at acquiring, maintaining, or reinforcing a qualified holding in a public company or to secure or frustrate the success of a takeover must be disclosed to the CMVM by any of the contracting parties within three days of their execution. The CMVM will determine the full or partial publication of the agreement, according to its relevance to the control over the company.

Company resolutions based on express votes exercised pursuant to agreements that have not been disclosed or published are voidable, except where one is capable of proving that the resolution would have passed without said votes. The duty to disclose qualified holdings also applies to the following categories of companies:

- Portuguese public companies which issue shares or other securities granting the right to their subscription or acquisition, admitted to trading on a regulated market situated or operating in Portugal when each of the following thresholds is attained: 2 per cent, 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, one-third, 50 per cent, two-thirds, and 90 per cent;
- Companies incorporated in other EU Member States that issue shares or other securities granting the right to their subscription or acquisition, exclusively admitted to trading on a regulated market situated or operating in Portugal, whenever each of the following thresholds is attained: 5 per cent, 15 per cent, and 25 per cent; and

- Companies incorporated in non-EU countries that issue shares or other securities granting the right to their subscription or acquisition, exclusively admitted to trading on a regulated market situated or operating in Portugal, and in relation to which the CMVM has been chosen by the issuer as the competent authority at the time of its admission to trading, whenever each of the following thresholds is attained: 5 per cent, 15 per cent, and 25 per cent.

Key exemptions are provided for parent undertakings of management/ investment companies where voting rights are exercised independently (subject to CMVM notification), for usual short settlement cycle and for market makers. However, the Securities Code no longer foresees the possibility of applying for specific exemptions (the CMVM could previously waive disclosure obligations in relation to holdings of 2 per cent and 5 per cent of the voting rights).

If the duty of disclosing qualified holdings is not complied with in accordance with the terms foreseen under the Securities Code, or should there be doubts as to the identity of shareholders of qualified holdings, the CMVM may notify the relevant issuer of such fact and request additional clarifications to be provided within 30 days, after which the CMVM may publish an announcement through its official Disclosure System stating that a specified shareholding is lacking transparency.

As a consequence of such declaration, the voting rights inherent to such shareholdings become automatically suspended. The following information regarding public companies must be disclosed:

- Exercise of subscription rights;
- Exercise of rights of conversion of securities into shares;
- Modification of the imputation title of voting rights in qualified holdings;
- Insolvency declaration application, judicial declaration of insolvency, or judicial refusal of such declaration and approval of the insolvency plan;
- Share capital increase and reduction;
- Applications to admissions to a regulated market and decisions thereunder; and
- General shareholders' meeting to consider the loss of public company status.

Market Participants

In General

The implementation of the MiDIF Directive has streamlined the Portuguese legislative approach to the protection of market participants both from the consumer and service provider perspective.

Qualified and Retail Investors

The most significant conduct of business rules imposed on the financial intermediaries by the MiFID requires that they categorise all clients (by

assessing their previous experience in dealing with financial instruments, as well as their financial condition and investment objectives) and adjust the level of client protection according to each client's expertise level when providing advice and services and choosing the complexity of the investment instruments that can be offered to such entities.

Accordingly, each financial intermediary must come to a decision on whether its client is a qualified or retail customer and let him be aware of such classification ahead of rendering any services. Retail clients are granted further information, assistance, and advice on the available financial instruments and agreements with such clients must be formalised in writing.

Qualified investors include credit institutions, investment firms, collective investment funds and their respective managing companies, insurance companies, pension funds and their respective managing companies, and other authorised or regulated financial institutions (including securitisation funds and their managing entities, and other financial companies) of non-EU Member States, traders in commodities derivatives, state entities, central banks, public entities that administer state debt and supra-national institutions (such as the World Bank, International Monetary Fund, European Investment Bank, and European Central Bank), and companies with a significant dimension for this purpose (ie, which meets two requirements out of €40 million net turnover, €20 million assets, and €2 million net assets).

The CMVM also may, by Regulation, tag as qualified investors other entities (including issuers) with particular experience and competence in relation to securities, by setting out economical-financial indicators to define when such is the case.

Retail customers can request to be re-characterised as qualified investors if they comply with two of the following requirements: have carried out at least 10 transactions of a significant amount per trimester in the last four trimesters, hold a portfolio exceeding €500,000, including deposits in cash, and have one year of professional financial experience.

Financial Intermediaries

The revised regulation on financial intermediation evidences a substantial effort in harmonising the organisation and conduct of business by investment firms, which was one of the main achievements intended by the MiFID implementation. The scope of the definition of 'financial intermediation' has been widened to include:

- Services and investment activities in financial instruments (such as order reception and execution, portfolio management, underwriting, book building, negotiation, multilateral negotiation systems management, and investment advice);
- Ancillary services to investment services and activities such as orders registration, custody, investment studies, or advice in the context of a public offer; and

- Management of collective investment schemes and custody of such entities' securities portfolio.

Credit institutions and investment firms, collective investment schemes managers, companies carrying out similar activities authorised to operate in Portugal, securities investment companies, and real estate investment companies are characterised as 'financial intermediaries', while brokers, dealers, asset management companies, foreign exchange agents, investment advisors, and multilateral negotiation systems operators are regarded as 'investment companies'. The Securities Code also holds consultants providing personalised investment advice services (either acting individually or as consultancy companies) as financial intermediaries.

In any of the cases described above, the performance of financial intermediation activities must be authorised by the competent authority and preceded by registration with the CMVM. An official list of authorised financial intermediaries and activities subject to CMVM supervision is permanently available on the regulator's official website.[11] The CMVM informs the European Securities and Markets Authority on the registration of investment companies and credit institutions that provide services or carry out investment activities and management companies of securities investment funds and of securities investment companies that manage collective investment in transferable securities.

Any financial intermediary based in a member state and authorised to carry out activities by one of the EU member state regulators can now freely provide intermediation services in Portugal under the European passport. A list of such authorised intermediaries also is available at the Committee of European Securities Regulators website.[12] The following information must be provided in writing by the financial intermediaries to enable the formation of a conscientious client investment decision:

- The financial intermediary's identification and the services provided;
- The nature of the retail or professional investor or eligible counterparty, for the possible right of requesting a different treatment and any restriction on the level of protection that such implies;
- The source and the nature of any interest that the financial intermediary or persons who act on behalf of same have in the services to be provided, whenever the organisational measures introduced by the intermediary are not sufficient to ensure with reasonable confidence that the risk of the clients' interests being prejudiced shall be avoided;
- The financial instruments and the proposed investment strategies;
- The specific risks involved in the transactions to be carried out;
- The order execution policy and, if applicable, provision for the possibility that clients' orders may be executed outside a regulated market or MTF;

11 See http://www.cmvm.pt.
12 See http://www.cesr-eu.org.

- The existence or non-existence of any guarantee scheme or similar protection that covers the provision of services; and
- The costs of the provision of services.

The information provided to clients must be sufficient to enable a non-qualified investor to assess the risks involved in a specified investment and must include at least a description of concepts such as volatility, 'leverage effect' of some financial instruments (ie, the risk of the exposure being higher than the amounts invested), or other risks associated with specific financial instruments (market, liquidity, credit or foreign exchange risks, and mandatory collateral provision) or markets.

The Securities Code also prescribes specific information check lists for each type of activity. Before receiving and executing any client order, the financial intermediary must request its client to expressly approve a document describing the financial intermediary's 'orders execution policy' (including to any amendments thereto), which must be adapted to the client's level of sophistication. Finally, financial intermediaries must forward their clients, up to the following business day after its execution, a detailed 'order completion report' and provide at any time information on the status of executed orders if so requested by their clients.

The provision of portfolio management services also must be preceded by specific support information, such as the identification of the relevant reference benchmarks enabling the investor to evaluate the performance of its portfolio, the provision of periodic reports on such performance (at least bi-annually), and alert notices each time pre-defined loss thresholds are achieved.

Good practice rules also require that financial intermediaries set up segregated client securities accounts so that these can be ring-fenced on insolvency of the former. Trading in client securities on the financial intermediary's or third parties' behalf is prohibited unless such client otherwise expressly consents to such utilisation, in which case he will have to be provided with details on the transactions involving his securities (responsibilities, risks involved, and restoring conditions).

Central Counterparties, Clearing, and Settlement

The trading on regulated markets or multilateral negotiation systems of options, futures, swaps, future contracts, and other derivatives over underlying securities, currencies, interest rates, indexes commodities, climatic variables, licenses, or other derivatives requires the mandatory intervention of a central counterparty.[13] Authorised credit institutions, settlement system operators, and clearing and central counterparties' operators can act as central counterparties.

13 The rules over the settlement of transactions in securities have been altered (ie, upgraded) in order to encompass the new reality of settlement systems now being intertwined, and a number of related issues have since been regulated (for instance, regulating where the liability ultimately lies in such intricate scenarios).

Securities settlement systems of capital markets operating in Portugal are created by written agreement under which common rules and standard procedures are adopted for the execution of transfer orders for securities between participants (which may include credit institutions, authorised investment companies, public entities, clearance agents, central counterparties, and settlement agents). With the exception of those managed by the Bank of Portugal, settlement systems must be recognised by way of registration with the CMVM. Only authorised credit institutions with activity in Portugal and centralized securities systems can act as settlement agents.

The settlement system that operates in the Portuguese regulated markets is managed by Interbolsa — *Sociedade Gestora de Sistemas de Liquidação e de Sistemas Centralizados de Valores Mobiliários*, S.A. Interbolsa settles market operations involving stocks, bonds, and notes and Eurosystem credit operations collateralised by Treasury bonds and private paper. In addition to its tasks as central securities depositary (registration, deposit, and safekeeping of securities) and settlement system, Interbolsa acts as the national securities numbering agency.

LCHClearnet, S.A. operates as a clearing house and as central counterparty for the operations carried out in the Euronext group markets, including Euronext Lisbon, in the spot market, and in the derivative market. In its capacity as clearing house and central counterparty, LCHClearnet's functions include registration, clearing, settlement, collateral management, and risk management associated with the operations carried out in Euronext Lisbon.

Public Offerings

In General

The Portuguese regulation of public offers reflects the conciliation achieved by the EU Member States covered by the Takeover Directive, the Prospectus Directive, and the Transparency Directive. Public offers are offers of securities addressed, in whole or in part, to unidentified addressees. The following offers are always deemed public:

- Offers addressed to all the shareholders of a public company, even if its share capital is represented by nominative shares;
- Offers that, in whole or in part, are preceded or accompanied by promotional material or book-building with unidentified addressees; and
- Offers addressed to at least 150 non-qualified investors who are domiciled in Portugal.

Offers concerning securities only addressed to institutional investors and subscription offers by non-public companies, addressed to their shareholders, and except for those cases described in the preceding paragraph, are considered private. The regulations are applicable to all offers specifically addressed to investors resident or established in Portugal (irrespective of the law regulating the securities object of the offer or the applicable statutory law of the offeror or

issuer). The following types of offers are excluded from the provisions of the Securities Code:

- Public distribution offers of debt securities issued by an EU member state or one of its regional or local authorities and public offers of securities that are unconditionally and irrevocably guaranteed by one of such states or authorities;
- Public distribution offers of securities issued by the European Central Bank or by the central bank of one of the EU Member States;
- Offers on securities issued by an open-ended collective investment fund, made by the issuer or on its behalf;
- Offers on or through a market registered with the CMVM that are presented exclusively through the market's own means of communication and that are not preceded or accompanied by promotional material or prospecting or book building from unspecified addressees;
- Public offers of securities with a nominal value of €100,000 or more or with a subscription or purchase price equal or above such amount;
- Public offers of debt securities issued by international public bodies to which one or more Member States belong;
- Public offers issued by associations or non-profit entities, recognised by a member state, with the purpose of obtaining funds for their non-profit activities;
- Public offers of debt securities issued in a sequential or repeated manner by credit institutions, so long as these securities are not subordinated, convertible, or exchangeable; do not grant the right to acquire other securities or are associated with a derivative instrument; certify the receipt of reimbursable funds; and are covered by the Bank of Portugal Deposit Guarantee Fund or a similar deposit guarantee scheme;
- Public offers of debt securities issued in a sequential or repeated manner by credit institutions with a total value (in the previous 12-month period) of below €75 million, so long as these securities are not subordinated, convertible, or exchangeable and do not grant the right to subscribe or acquire other securities or are associated with a derivative instrument;
- Public offers of securities with a total value below €5 million in a 12-month period;
- Public offers of shares issued to replace shares already issued in the same class, if the issue of these new shares does not imply a share capital increase;
- Public offers of securities issued by collective investment undertakings; and
- Public offers of debt securities with a maturity of less than one year.

Registration, Approval, Documentation, and Publicity

Without prejudice of the above exclusions, distribution offers prospectuses are subject to prior approval and takeover bids are further subject to prior registration with the CMVM.

The request for approval of the prospectuses or registration must include the following documents (unless updated versions of the same are already in the possession of the CMVM):

- Resolution launching the offer adopted by the offeror's competent statutory body, and of the required management decisions;
- Issuer's and offeror's up-to-date by-laws and commercial registry certificates;
- Management and financial reports of the statutory auditing body as well as the audit reports covering the issuer's accounts for the periods set out in EC Regulation Number 809/2004 (ie, 2004 onwards);
- Report or statement from an independent auditor;
- Identification code (ISIN) of the securities which are the object of the offer;
- Copy of the agreement entered into with the financial intermediary assisting in the operation;
- Copy of the underwriting agreement and the underwriting consortium agreement, if applicable;
- Copy of the market placement agreement, stabilisation agreement, and the 'greenshoe' (over-allotment) agreement, if such agreements exist;
- Draft prospectus;
- *Pro forma* financial information (if applicable);
- Draft public offer announcement; and
- Expert reports (if applicable).

The CMVM also may request from the offeror or the issuer any complementary information that it thinks useful. The offeror must be informed within eight days of the takeover registration or its respective refusal and within 10 days of the public distribution offer prospectus approval or refusal, save in the cases where the issuer has not previously carried out any public distribution offer or admission to a regulated market, in which case the period is extended to 20 working days.

Registration of the takeover and approval of the prospectus may only be refused when (having given the applicant the opportunity to remedy the same) any of the documents used in the preparation of the request is false or does not conform to the legal or regulatory requirements or, in the case of takeover registrations only, registration of the offer is illegal or fraudulent.

All of the publicity materials related to a specified public offer are subject to prior approval by the CMVM, which may authorise advertising in advance of the approval of the prospectus or registration of the offer, as long as it does not cause problems to the addressees or to the market.

Launch, Execution, and Amendments

All public offerings of securities in relation to which the drafting of a prospectus is mandatory require the intervention of a financial intermediary, who will

provide at least assistance and placement services, in public offers for distribution and assistance services in the context of takeover bids, following the preliminary announcement as well as receipt of acceptance orders. Compulsory intermediation can nevertheless be provided by the offeror itself if it is duly authorised to act as a financial intermediary.

The price of the offer is a single one, except for the possibility of different prices according to different classes of securities or addressees, fixed in objective terms and in the legitimate interest of the offeror. The offer can only be subject to conditions that correspond to the offeror's legitimate interest and that do not affect the normal functioning of the market — it can never be subject to conditions the verification of which depends on the offeror.

The acceptance of the offer by the addressees is made through an order addressed to a financial intermediary, which can be revoked up to five days before the offer's deadline or within a shorter term if set out in the offer documentation. At the end of the offer period, the offer result is immediately assessed and disclosed by a financial intermediary who gathers all the acceptances received, or in a special regulated market session. In the case of a public distribution offer, the financial intermediary or the operator of the regulated market also must inform if admission to trading on a regulated market has been applied for.

In the case of an increase in the risks of an offer due to an unforeseen and substantial modification of the circumstances on which, as known to the addressees, the decision to launch the offer was based, the offeror may, within a reasonable period and by means of the CMVM's authorisation, modify or revoke the offer. This is the only circumstance under which the offeror may revoke the offer. The offeror may also modify the offer by reducing the price initially announced by at least 2 per cent and by reviewing the consideration as to its nature and amount up to five days before expiry of the bid period (a reviewed bid cannot contain conditions making it less favourable and its consideration must be at least 2 per cent greater than the preceding offer as to its amount.)

Prospectus Requirements and Liability

As a general principle, the launch of any public offer of securities must be preceded by the publication of a prospectus approved by the CMVM, but the following types of public offers are exempt from this requirement:

- Offers of securities as a result of a merger or de-merger, to at least 150 shareholders who are not qualified investors (so long as a document is made available to these with information that the CMVM considers equivalent to that of a prospectus);
- Payment of dividends in the form of shares of the same class as those that granted the right to the dividend (so long as an informative document is prepared containing the number and nature of the shares and the reasons and characteristics of the offer); and

- Offers of securities to management or employees by their employer (or a subsidiary of their employer) when the latter has listed securities (so long as an informative document is prepared containing the number and nature of the shares and the reasons and characteristics of the offer).

The issuer also may prepare a basic prospectus (which must be the subject of an addendum whenever updated information is available), for public offers of debt securities, including warrants, issued in the context of a programme (ie, at least two issues during a 12-month period) or debt securities issued continuously or repeatedly by a credit institution (so long as the amounts received are used to invest in assets that secure the liabilities of these securities until their maturity date and, in case of insolvency of the issuer, the amounts are used on a priority basis to pay the principal and interest of the securities). The contents of such base prospectus are defined in EC Regulation Number 809/2004.

A prospectus must include information on the individuals who are responsible for its content, the objectives of the offer, the issuer and its activity, the offeror and its activity, the issuer's corporate governance structure, the name of the members of the issuer's and the offeror's statutory bodies, and the financial intermediaries that are members of the underwriting consortium, when such exists. In addition to these, specific information requirements must be included according to each type of offer as described below.

The prospectus of a public distribution offer (to which EC Regulation 809/2004 also applies) must include a summary that refers to the essential characteristics of the offer and the risk factors associated with the issuer, the guarantor (if applicable), and the securities object of the offer. If the public distribution offer affects securities already admitted or expected to be admitted to trading on a regulated market situated or functioning in Portugal or in any other EU member state, a single prospectus satisfying the requirements for both effects can be approved and used.

When the definitive price or the number of the securities object of the offer cannot be stated precisely, the prospectus may omit this information so long as the criteria for determining these factors is set out, and the addressees may cancel their orders within at least two working days after the factors are fixed. Takeover prospectuses also must include information on:

- The consideration offered and its justification;
- The minimum and maximum amounts of securities that the offeror intends to acquire;
- The percentage of voting rights that can be exercised by the offeror in the target company and by the target company in the offeror company as well as the identification of the persons that may be related with qualified shareholders of the offeror or the offeree;
- An indication of the securities that have been acquired in the previous six months by the issuer, of the same class as those that are the object of the offer, with acquisition dates, amount, and consideration paid;

- The offeror's intentions with regard to continuity or modification of the business activity developed by the target company and, insofar as it is affected by the bid, the offeror company and, in the same terms, companies that have a control or group relationship with the offeror or offeree, consequences in terms of personnel policy, place of business, and financial strategy, maintenance of the public company status, and admission on a regulated market of the securities which are the object of the offer;
- The possible implications of the success of the offer on the offeror's financial situation as well as in the funding of the bid;
- The shareholders' agreements entered into by the offeror with significant influence over the target company;
- The agreements entered into between the offeror and any persons related with qualified shareholders or members of the corporate bodies of the target company;
- The method of payment of the consideration when the securities that are the object of the offer are also admitted to trading on a regulated market situated or functioning abroad;
- The compensation proposed in the event of removal of rights with the form of payment and method used to calculate its amount;
- The domestic legislation that will apply to agreements entered into by the offeror and holders of securities in the offeree company, following acceptance of a bid, as well as the courts having jurisdiction to resolve any disputes resulting therefrom; and
- Any charges to be borne by the addressees of the bid.

If the consideration consists of securities, issued or to be issued, the prospectus must include all information which would be required if the securities were the object of a public offer for sale or subscription. At the request of the issuer or offeror, the CMVM may authorise the omission from the prospectus of information the disclosure of which would be contrary to the public interest, or seriously detrimental to the issuer, as long as such omission would not be likely to mislead the public with regard to facts or circumstances, the knowledge of which is essential for the assessment of the securities which are the object of the offer or if such information is not material. The prospectus may only be disclosed after approval by the CMVM, and must be made available to the public in reasonable advance of the offer launch by way of:

- Publication in one or more newspapers of mass circulation throughout the country;
- In the form of a brochure available, free of charge, to the public, in particular at the offeror's and issuer's headquarters, at the headquarters and branches of the financial intermediaries in charge of gathering the addressee's orders, and at the headquarters of the operator of the regulated markets in which the securities are or will be admitted to trading; or

- In the website of the issuer, the financial intermediaries responsible for underwriting the offer, the regulated market where listing has been sought, or the CMVM.

If either of the first two methods is used, the prospectus also must be made available in electronic format in one of the sites referred to in the last point. The CMVM is the competent entity to approve a prospectus of public distribution offers where the issuers have their registered offices in Portugal, in the case of shares and other securities that give right to their subscription (and as long as the issuer also is the issuer of the underlying securities), with a par value of below €1,000.

The member states where the issuer has his registered office or in which the securities have been or will be admitted to trading or offered to the public are, at the option of the issuer or the offeror, competent in relation to distribution offers of debt securities and other securities that give right to their subscription or equivalent cash amounts (as long as the issuer of such securities is not simultaneously the issuer of the underlying securities or a group member of such issuer) with a par value of more than €1,000. The CMVM may delegate its approval powers in relation to a prospectus to an authority in another member state, with the latter's agreement and with notice to the European Securities and Markets Agency.

A prospectus approved in another member state for a public distribution offering to be made in Portugal and in another member state is valid in Portugal so long as the CMVM receives an approval certificate from the authority of the other member state and a copy of the approved prospectus (with a translation of the summary).

The prospectus of a takeover bid over securities admitted to trading on a regulated market situated or operating in Portugal and approved by a competent authority of another member state will be recognised by the CMVM, provided that such prospectus is translated into Portuguese and that a certificate, issued by the competent authority responsible for approval of the prospectus, stating that the prospectus meets the relevant Community and national provisions, accompanied by the approved prospectus, is made available to the CMVM. The CMVM may require that any supplementary information resulting from the specificities of the Portuguese regime concerning formalities relating to consideration payment, acceptance of the bid, and tax regime applicable thereto be added to the prospectus.

The offeror, the members of the offeror's management body, the issuer, the members of the issuer's management body, the promoters (in the case of offer for subscription for the incorporation of a company), the members of the auditing body, accounting firms, and any other individuals that have certified or, in any other way, verified the accounting documents on which the prospectus is based, the financial intermediaries in charge of assisting with the offer, and any other entities that agree to be named in the prospectus as being responsible for

any information, forecast, or study included in the same are potentially liable for damages caused by errors or inaccuracies in the prospectus, unless they prove they have acted without fault.

Liability can be avoided if any of the individuals concerned prove that the addressee knew or should have known about the deficiency of the prospectus' content on the date of issue of the contractual declaration or when cancellation of the securities transaction was still possible, or if the damages arose from the summary of the prospectus or its translation, unless when read with the rest of the documentation it contained erroneous, misleading, or incompatible information or it doesn't provide fundamental information to allow the investors to determine if and when they should invest in the mentioned securities.

Distribution, Subscription, and Public Sale Offers

Following the implementation of the Prospectus Directive, the former principle of prior registration of all offers was revoked, the current approval of public distribution and subscription offers resulting now from the corresponding prospectus approval.

In relation to public distribution offers, the Securities Code set out a specific information disclosure duty: the issuer, the offeror, and financial intermediaries must, until the information relating to the offer is made public, limit the disclosure of information related to the offer to what is necessary to fulfil the objectives of the offer, warning the addressees as to the privileged nature of the information issued, and limit the use of privileged information to such purposes as necessary for the preparation of the offer.

Additional documentation requirements are imposed for the application for approval of a public subscription offer to incorporate a company, which must include the identification of the promoters, evidence of the subscription of the minimum share capital by the promoters, a copy of the draft by-laws, and a provisional commercial registration certificate. The launch by the same entity of a new public subscription offer of securities of the same kind as those which had been the object of a previous offer, or the launch of a new series, is subject to the prior full payment of the subscription price by all addressees (or giving notice to those that have not yet paid up) of the previous series or issue.

The application for approval of the prospectus of a public sale offer is submitted with documents that evidence that the securities offered have been blocked. The issuer of securities distributed in a public sale offer must provide the offeror, at the latter's expense, with the information and documentation necessary to prepare the prospectus. The Securities Code allows a reduction of not more than 2 per cent of the price first announced in the context of a public sale offer.

The Securities Code allows bookbuilding to determine the viability of a proposed public distribution offer but never in cases of takeovers. Bookbuilding may only commence after the disclosure of the preliminary prospectus, and no offers may be or are made through the bookbuilding process, although more

favourable subscription or purchase rights may be offered to those consulted. The preliminary prospectus for bookbuilding purposes is subject to approval by the CMVM.

Takeover Bids

The CMVM will have powers to supervise any takeover bids where the target issuers:

- Have their registered offices in Portugal, provided the securities concerned by the bid are admitted to trading on a regulated market situated or operating in Portugal or are not admitted to trading on a regulated market at all; or
- Are subject to a foreign law, provided that the securities concerned by the bid are admitted exclusively to trading on a regulated market located or operating in Portugal; or, if these are not admitted to trading in the member state where the registered office of the issuer is located, have been first admitted to trading on a regulated market situated or operating in Portugal.

If the admission to trading of the securities concerned by the bid is simultaneous in more than one regulated market of several Member States but does not include the member state where the registered office of the issuer is located, the issuer must, on the first day of trading, choose the competent authority to supervise the bid from among the authorities of such Member States and notify such decision to the regulated markets in question and the corresponding supervisory authorities.

The following rules concerning public offer announcements, duties to report any transactions carried out, issuers' duties, competing offers, and mandatory takeovers are not applicable to takeover bids over securities other than shares or securities incorporating the right to acquire shares. As soon as the decision to launch a takeover is taken, the offeror must address a notice to the CMVM, to the issuer, and to the operators of the markets in which the securities object of the offer or included in the consideration are admitted to trading, and publish a preliminary announcement giving notice as to:

- The identity and head office of the offeror, the target, and the financial intermediary in charge of assisting with the offer;
- The securities object of the offer;
- The consideration offered;
- The percentage of voting rights held in the target company directly by the offeror or by related entities;
- A summary statement of the offeror's intentions, notably with regard to continuity or alteration of the business of the target company and, insofar as it is affected by the bid, the offeror company, and, in the same terms, companies which have group or control relationships with the offeree or offeror companies; and

- The status of the offeror with respect to the management limitations imposed on the target following the offer announcement and on the suspension of statutory limitations to transfer of shares and voting rights.

The determination of a maximum or minimum limit of the quantity of securities to be acquired and the subjection of the offer to any conditions will only be effective to the extent that they are included in the preliminary announcement. The preliminary announcement binds the bidder to launch the offer in terms not less favourable than those disclosed in such document, to apply for the takeover registration within 20 days (this term can be extended up to 60 days by the CMVM), and to inform the workforce representative of the contents of the offer document following its disclosure. Until the publication of such announcement, the offeror, the target, its shareholders, and its service providers are subject to a confidentiality duty.

Consideration for the securities that are the object of the offer can consist of cash, securities (already issued or to be issued), or both. The offeror must deposit the relevant cash amount in a financial institution or present an adequate bank guarantee, before registering the offer. Securities eligible to incorporate the consideration must have adequate liquidity and be easy to value. Should these have already been issued, they must be registered or deposited frozen to the order of the offeror in a centralised securities system or with a financial intermediary.

If these are not issued by the offeror, the preliminary announcement and the public offer announcement of the takeover also must indicate the information relating to the issuer and the securities issued or to be issued by the same, similarly to that contained in the offer announcement. In addition to the above general requirements on prospectuses approval, the application for registration of takeovers submitted to the CMVM should include documents evidencing the following facts:

- Submission of the preliminary announcement, the draft public offer announcement, and the draft prospectus to the target company and to the competent authorities of the regulated markets in which the securities are admitted to trading;
- Deposit of the consideration in money or issue of a bank guarantee which guarantees its payment; and
- Freezing of issued securities comprised in the offer consideration.

As from the publication of the preliminary announcement and until the assessment of the offer's result, the offeror and its entities related to such offerors for the purposes of qualified shareholdings attribution become subject to certain limitations. They cannot trade, outside the regulated market, securities of the class of those which are the object of the offer or of those which comprise the consideration except if authorised by the CMVM with a previous report from the target company, and must inform the CMVM daily of

the transactions carried out by each of them relating to the securities issued by the target company or of the class of those which make up the consideration offered.

The securities of the class of those which are the object of the offer, acquired after the publication of the preliminary announcement, will be included in the calculation of the minimum amount which the offeror proposes to acquire. In the context of voluntary takeovers, the CMVM may determine the review of the consideration (if, due to such offeror acquisitions the initial consideration does not appear reasonable) while, in mandatory takeovers, the offeror must raise the consideration up to an amount equal to the highest price paid for the securities acquired. During this same offer period, the target management members must inform the CMVM of any dealings by such entities (or related entities thereto) in securities issued by the target.

The publication of the takeover preliminary announcement also triggers limitations and obligations from the target's perspective. The management body of the target company cannot carry out any acts that materially affect the net asset situation of the target company and which can significantly affect the objectives announced by the offeror (excluding the normal day-to-day management of the company) from the moment it has knowledge of the bid launch decision for a takeover for more than one-third of the securities of the respective class, and until the assessment of the result or until the termination of the respective process.

The scope of this restriction includes execution acts of decisions approved before the above-referred acknowledgment which have not yet been partially or totally implemented (excluding, nevertheless, obligations assumed by the target before such period, acts authorised by a general shareholders' meeting convened for this purpose, and acts intended to seek competing bids).

In addition, within eight days of receipt of the draft prospectuses and announcement of the bid and within five days of disclosure of any addenda to the offer documents, the board of directors of the target company must send to the offeror and the CMVM and disclose to the public a report on the opportunity and terms of the offer, which must include an opinion on the following aspects: type and amount of the consideration offered, offeror's strategic plans for the target company, consequences of the bid on the interests of the target company in general and, in particular, on the interests of its employees and their terms of employment as well in the company's places of business, and the intentions of members of the boards who are simultaneously shareholders in the target company in respect of acceptance of the bid. Should the board receive from the target's employees an opinion on the repercussions of the bid on employment, it must enclose such opinion as an appendix to the board report.

The Takeover Directive also contemplates the abolition of a series of defensive barriers in the context of takeover bids, including non-application of restrictions to the transfer of voting rights or restrictions concerning voting rights or multiple votes. These were implemented by the Securities Code, which now

foresees the possibility of public companies introducing statutory suspensions of the effectiveness of restrictions on transfers and voting rights (which will therefore not apply to transfers resulting from acceptance of a bid) if following the launch of a takeover bid the offeror holds at least 75 per cent of the target's voting rights.

This 'breakthrough rule' is nevertheless not mandatory (it can be adopted at the public companies' shareholders' criteria) and subject to the principle of reciprocity (ie, the by-laws can state that the suspension regime does not apply to takeover bids conducted by offerors which are not subject to the same rules). Amendments to public companies' by-laws for the purposes described above must be disclosed to the CMVM and the public when such companies are subject to Portuguese law.

Following approval of the takeover prospectus and registration of the takeover bid by the CMVM, the offeror of a takeover bid must publish a public offer announcement containing the essential elements of the offer, including:

- The identification of offeror, issuer, and financial intermediaries;
- Capacity in which the financial intermediaries act in the offer;
- The type and number of securities object of the offer;
- The type of offer;
- The price and terms of payment;
- The duration of offer period;
- The criteria for over-subscription;
- The conditions precedent for the validity of the offer;
- The percentage of voting rights held by the offeror and related parties in the target company;
- The locations where the prospectus is available; and
- The identification of the entity responsible for the calculation and disclosure of the results of the offer.

The public offer announcement must be published, at the same time the prospectus is disclosed, in a communications media with wide circulation in the country and in a communications media indicated by the operator of the regulated market where the securities are listed.

The offer period for the takeover can vary between two and 10 weeks, counting from the disclosure of the offer announcement. The CMVM, at its discretion or at the request of the offeror, can extend the offer period in case of modifications, launches of competing offers, or when the protection of the interests of the addressees so justifies. Until five days before the end of the term of the offer, the offeror may revise the consideration, in relation to its type or amount. The revised consideration must be at least 2 per cent greater in value than the previous one. The declarations of acceptance of the offer prior to the revision are considered effective for the revised offer.

As from the publication of the preliminary announcement of the takeover for securities admitted to trading on a regulated market, any other takeover of the same class of securities may only be carried out through a competing offer, which will also be subject to the rules applicable to takeover bids. The competing offer must be launched up to five days before the end of the offering period of the initial offer, for a scope at least equivalent to that of the initial offer and for a consideration amount 2 per cent higher than such offer. Entities holding voting rights which can be deemed attributed to the initial offeror are not allowed to launch any competing offer.

Mandatory Takeover Bids and Squeeze-Out Provisions

In accordance with the reasoning that the benefits resulting from the control over public companies should be shared with minority shareholders, the Securities Code sets out a duty to launch a mandatory takeover bid (over the remaining shares and other securities conferring the right to subscribe shares issued by the target) each time a shareholder exceeds, directly or indirectly, one-third and 50 per cent of effective voting rights attributable to the existing share capital of a public company.

However, an effective dominium criteria is adopted, which means that the launch of an offer is not required when the shareholder exceeding the limit of one-third proves that it has neither control of target nor is in a group relationship with such target (but will be under the obligation to notify the CMVM of any increase in aggregate of more than 1 per cent in its voting rights). The one-third trigger can be overruled by the company's by-laws.

The consideration offered in a mandatory takeover context is subject to rigid determination criteria. The amount offered must be the higher of the highest price paid by the offeror (or by any person holding rights which are deemed attributable to the offeror) for acquisition of shares in the six months preceding the publication of the offer announcement or the average price of those securities on the regulated market during the same period.

Furthermore, if the bidder chooses to offer securities as consideration, it must designate a cash alternative of equivalent value. If the consideration cannot be calculated by reference to the criteria referred to above or if the CMVM decides that the consideration, in cash or securities, proposed by the offeror is not justified or equitable, or is insufficient or excessive, the minimum consideration will be calculated, at the offeror's expense, by an independent auditor designated by the CMVM.

Exemptions to the mandatory bid rule are foreseen when the thresholds are exceeded as a result of the acquisition of securities in the course of a takeover launched without any restriction relative to the quantity or maximum percentage of securities to be acquired, the execution of a financial redress plan, or the merger of companies, as long as the resolution of the general meeting of the potential target expressly specifies that the merger would result in the duty to launch a mandatory takeover. The exemption must be recognised by way of a

declaration issued by the CMVM at the request of the interested party and published immediately. The duty to launch a takeover can otherwise be suspended if the entity bound by it undertakes to terminate the situation triggering the duty to launch the takeover in the following 120 days, by way of written notice addressed to the CMVM.

Squeeze-out procedures apply to bidders that, following a takeover offer, acquire (directly or indirectly) 90 per cent of the voting rights (up to the determination of the outcome of the bid) corresponding to the share capital of a public company subject to Portuguese statutory law and 90 per cent of the voting rights covered by the bid, and who may compulsorily acquire the remaining shares of the company for a fair consideration in cash, within three months after the assessment of the offer's result.

The squeeze-out procedure entails the publication of a preliminary announcement which must be sent to the CMVM for registration and deposit of the consideration on behalf of the holders of the remaining shares with a credit institution. The compulsory acquisition becomes effective on publication of the offer registration with the CMVM and implies the immediate loss of public company status, as well as the exclusion of the securities from the relevant regulated market.

If the squeeze-out procedure is not timely initiated by the offeror, the holders of the remaining shares can, within three months after the assessment of the offer's result, exercise their rights to sell out, addressing the controlling shareholder an invitation to make a proposal to acquire their shares within eight days.

If no offer or a non-satisfactory offer is received, the remaining shareholders can decide to compulsory sell out by providing the CMVM with a notice to this end with evidence enclosed of the deposit or freezing of the shares and account of the consideration calculated according to criteria set in the Securities Code. In such cases, the sale becomes effective from the date of CMVM notification to the controlling shareholder.

Criminal Offences

Insider Dealing and Market Manipulation

Any one who holds privileged information due to their capacity as member of a managing or supervisory body of an issuer or as shareholder, or due to their profession or public function or having otherwise obtained the information illicitly, and who passes on this information to someone outside the regular scope of its functions or, based on this information, trades or advises someone to trade in securities or in other financial instruments, or orders their subscription, acquisition, sale, or exchange, directly or indirectly, on their own account or for third parties, is punishable with imprisonment for a maximum of five years or with a fine up to a maximum of 360 days.

For the purposes of insider-dealing provisions, privileged information is understood to be all non-public information that, being accurate and with

respect to any issuer or securities or other financial instruments, would be capable, if it were given publicity, of influencing in a sensitive manner its price in the market.

Entities which are not listed above but who have access and pass on such information or trade or advise someone to trade in similar conditions (tippers) are also subject to imprisonment for a maximum of four years and fines of a maximum of 240 days.

Market manipulation practices include disclosure of false, incomplete, exaggerated, or biased information and effecting fictitious operations or fraudulent practices capable of artificially varying the regular functioning of the securities or other financial instruments market so as to change the conditions of price development, the regular conditions of offer or demand, or the normal conditions of issue and acceptance of a public offering. Such actions are punishable with imprisonment for a maximum of five years or a fine up to a maximum of 360 days.

The members of the managing entity and those responsible for the direction or inspection of areas of activity of a financial intermediary who, being aware of the facts above described, performed by persons directly subject to their direction or inspection and in the performance of their functions, do not stop them immediately, will be co-liable and subject to imprisonment for a maximum of four years or a fine payable up to a maximum of 240 days, if a more serious punishment is not applicable under any other legal provision.

Proceedings

The attempt of any of the two above crimes also will be punished, even if the criminal act does not reach its execution. Once the facts that may be qualified as crimes against the securities or other financial instruments have been established, the executive board of the CMVM may determine the commencement of preliminary investigation proceedings. The process of investigation is initiated and directed by the executive board of the CMVM, which can require the defendant to present all necessary explanations, information, documents, objects, and elements required to confirm or deny the suspicion of crime against the securities or other financial instruments market.

For this purpose, the CMVM may proceed with the seizure and inspection of any documents, independently of their media, assets, or objects associated with the possible practice of crimes against the securities or other financial instruments market, or proceed with the sealing of objects not seized in the premises of the persons and entities subject to their supervision, to the extent necessary for the investigation of the possible existence of crimes against the securities or other financial instruments market.

The CMVM also may apply the following accessory penalties to any insider dealer or market manipulator disqualification, for a period not exceeding five

years, of the practice by the agent of the profession or activity associated with the crime, including prohibition of the practice of management, direction, command, or inspection and, in general, representation of any financial intermediary, in the scope of some or all intermediary activities in securities or in other financial instruments, and publication of the condemnation sentence, at the expense of the defendant, in locations adequate to satisfy the objectives of general prevention of the legal system and the protection of the securities or other financial instruments market. The perpetrator of the crime will also be obliged to deliver any benefits received from the committed crimes.

Misdemeanors

The Securities Code also contains a long list of actions qualified as misdemeanors which may incur fines, quantified depending on the seriousness of the action:

- Between €25,000 and €5 million when very serious;
- Between €12,500 and €2.5 million when serious; and
- Between €2,500 and €500,000 when qualified as less serious.[14]

Very serious misdemeanors include the following actions: disclosure of information that is not complete, true, updated, clear, objective, and licit; the failure to submit documents to the Information Disclosure System of the CMVM; and failure to communicate or publish qualified holdings, transfer of frozen securities, execution of a public offering without approval of the prospectus or prior registration with the CMVM, and non-launching of a mandatory takeover.[15]

Jurisdictional Conflicts

In General

The revised Securities Code recognised the inadequacy of the existing general rules adopted by law or international conventions such as the Rome or Hague Convention to determine the law which should govern multinational situations arising from the internationalisation of the securities markets.

Accordingly, the Securities Code has adopted specific rules on jurisdiction conflicts, setting out both multilateral and unilateral techniques to settle potential jurisdiction conflicts.

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14 Misdemeanors are punishable whether intentional or solely negligent, and attempt also is punishable.

15 On 24 May 2011, Law Number 46/2011 was enacted and, as from its entry into force, a new court (specialised in competition, financial regulation, and supervision) has been set up in order to, notably, rule on appeals of decisions or any other legally challengeable measures taken by the CMVM, under misdemeanor procedures.

Multilateral Approaches — Procedural Solutions

The Securities Code provides bilateral conflict of laws rules which do not provide material solution to the relevant situation but, instead, determine the law which should govern such situation (which in actual fact can either be Portuguese or foreign law) according to a specified connection factor.

As a general principle, the conflict of law rules in the Securities Code also allocate directly the material law rules applicable by the foreign system, therefore excluding the possibility that the resolution of the conflict be forwarded to another system of law by the foreign conflict of law rules. Among the unilateral solutions adopted are:

- The capacity to issue securities where the form of its representation will be ruled by the *lex personalis* of the issuer, which is primarily determined by the company's head office;
- As a general rule, the contents of the securities will also be ruled by the *lex personalis*, but the Securities Code grants the issuer of bonds or debt security the possibility to elect another jurisdiction, as long as the choice of law is mentioned in the offering registration; and
- The assignment and granting of security over specified securities will be governed, as to securities integrated in a centralised system, by the law of the state in which the entity managing such system is located; as to registered or deposited securities not integrated in a centralised system, by the law of the state in which the entity where such securities are registered or deposited is located; and, as to securities which are neither integrated in a centralised system nor registered or deposited, by the *lex personalis* of the issuer.

Unilateral Approaches

In most cases, the private international law solutions adopted in the Securities Code represent unilateral approaches, where substantive material law solutions (which directly regulate international situations, instead of designating the applicable law) are provided.

Rules of Mandatory Application

The Securities Code also provides rules which demand mandatory application, even in the context of international situations that would otherwise be subject to foreign law in accordance with the general Portuguese conflict of law rules, provided that a material connection can be established between such situations and the Portuguese jurisdiction.

Such material connection to the Portuguese territory will be likely to exist when orders are addressed to regulated markets members or multilateral negotiation systems (multilateral negotiation systems) members registered with the CMVM, and operations are carried out therein, activities are carried out, and acts are performed in Portugal, or diffusion of information is made accessible in Portugal making reference to situations, activities, or acts regulated by Portuguese law.

Romania

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Romania

Sorin David
D&B David si Baias
Bucharest, Romania

Introduction

Regulatory System

The Romanian securities system is placed under the authority of the National Securities Commission (*Comisia Naţională a Valorilor Mobiliare*, the CNVM), which is one of the four regulatory and supervisory authorities in the Financial Services sector (together with the National Bank of Romania, the Insurance Supervisory Commission, and the Commission for Supervision of the Private Pensions System).

The first law to regulate (in a somewhat consistent manner) the securities system was Government Ordinance Number 18/1993 regarding the regulation of off-market transactions with securities and the organization of intermediation institutions. This legislation established the Securities Agency (*Agentia de Valori Mobiliare*) as a general department within the Ministry of Finance and introduced some general rules as regards intermediation activities, investors' protection and public offers.

However, it would be reasonable to argue that the first major piece of legislation of the securities sector was Law Number 52/1994 on securities and stock exchanges, which regulated the statute of the CNVM as an autonomous administrative authority with legal personality and laid down the general rules applicable to securities, public offers, intermediation of securities, organization and functioning of stock exchanges, stock exchange operations, and investor protection.

It was repealed by Government Emergency Ordinance Number 28/2002 on securities, investment services, and regulated markets, which brought a substantially wider regulation of the securities system. In consideration of the expected accession of Romania to the European Union (EU) in 2007, Law Number 297/2004 on capital market (the "Capital Market Law") repealed Government Emergency Ordinance Number 28/2002 and implemented EU rules in the securities sector, mainly:

- Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (the "Investment Services Directive");

- Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (the "Prospectus Directive");
- Council Directive of 20 December 1985 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (the "UCITS III Directive"); and
- Directive 2003/6/EEC on market abuse (the "Market Abuse Directive").

Regard also should be had to Law Number 31/1990 on trading companies (the "Company Law"), which is the core regulation for companies, laying down the basic rules regarding the establishment and functioning of companies, their administration, corporate governance rules and specific provisions concerning share capital alterations, amendments of the articles of incorporation, mergers and spin-offs, and liquidation and dissolution.

Legal Sources

As mentioned above, the most important legislation in the securities area is the Capital Market Law, which sets out the general rules as regards:

- Intermediaries;
- Regulated Markets for financial instruments and the Central Depository;
- Market operations;
- Issuers; and
- Market abuse.

The Capital Market Law no longer regulates the statute of the CNVM, which is currently governed by Government Emergency Ordinance Number 25/2002 regarding the approval of the Statute of the National Securities Commission (the "the CNVM Statute"). Other important legislation includes:

- Law Number 253/2004 on settlement finality in payment and securities settlement systems, implementing Directive 98/26/EC on settlement finality in payment and securities settlement systems;
- CNVM Regulation Number 1/2006 on issuers and securities operations by which there were implemented, partially or entirely, the provisions of the Prospectus Directive, the Market Abuse Directive, Directive 2004/39/EC on markets in financial instruments (the "MiFID"), Directive 2004/25/EC on takeover bids, and Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market;
- CNVM Regulation Number 2/2006 on regulated markets and alternative trading systems, by which some of the provisions of MiFID were implemented and which regulates in a detailed manner the set-up,

authorization and functioning of regulated markets, market operators (ie, stock exchanges), alternative trading systems, and system operators;

- CNVM Regulation Number 15/2004 on the authorization and functioning of management companies, undertakings for collective investments and depositories, partially transposing into the Romanian legislation the provisions of the UCITS III Directive; and
- CNVM Regulation Number 13/2005 on the authorization and functioning of the central depository, clearinghouses, and central counterparty.

The Government enacted GEO 32/2012 on undertakings for collective investments in transferrable securities and asset management companies, as well as amending Law Number 297/2004 (the 'UCITS Ordinance'). The legislation repealed the UCITS chapter formerly regulated by the Capital Market Law and is the main legislative act regulating UCITS and asset-management companies.

Moreover, the UCITS Ordinance implemented the provisions of Directive 2009/65/EC on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (the 'UCITS IV Directive').

Authorities and Procedure

The securities system's regulatory authority is the CNVM. According to the CNVM Statute, the CNVM is an autonomous administrative authority, independent, self-financed, and having a legal personality. The CNVM regulates and supervises the capital market, commodities and financial derivatives regulated markets, as well as the institutions, instruments and specific operations of those markets and represents the competent regulatory authority in Romania, as indicated under article 22 in Regulation (EC) 1060/2009 on credit rating agencies. The CNVM has the fundamental objectives to:

- Establish and maintain the framework for development of financial instruments markets;
- Promote confidence in financial instruments markets and investments in financial instruments;
- Ensure protection for operators and investors against unfair, abusive and fraudulent practices;
- Promote a correct and transparent functioning of financial instruments markets;
- Prevent the fraud and manipulation of the market and to ensure the financial instruments markets' integrity;
- Set standards of financial soundness and honest practice on financial instruments markets;
- Adopt the necessary measures in order to avoid systemic risk on the financial instruments markets;

- Prevent the impairment of equal information and treatment of investors on financial instruments markets; and
- Cooperate with similar international authorities, in order to achieve its objectives.

In order to meet its most important objectives, the CNVM must be previously consulted by any public authority that intends to issue a legislative act that has an impact over the capital market, commodities and financial derivatives regulated markets, as well as the institutions, instruments, and specific operations of those markets. The CNVM is competent to supervise the activity of the regulated entities and may apply various sanctions for breaches of the securities legislation, such as warning, fine, and complementary contravention sanctions, such as suspension of authorization, withdrawal of authorization, or temporary prohibition of performance of activities and services that fall under the remit of the law.

The National Bank of Romania is the regulatory authority of the banking sector, thus regulating and supervising an important category of the intermediaries that are allowed to perform investment services, i.e., credit institutions. The National Bank of Romania performs its supervisory attributions under Government Emergency Ordinance Number 99/2006 on credit institutions and capital adequacy, as well as Law Number 312/2004 on the Statute of the National Bank of Romania.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. Two stock exchanges operate in Romania. The Bucharest Stock Exchange[1] (*Bursa de Valori Bucureşti*, the BVB) was founded and inaugurated in 1882, but was dissolved after the taking over of the Communist regime in Romania in 1948. Its re-inauguration took place in 1995, as a consequence of the Romanian Revolution in December 1989 that led to the abolishment of the Communist regime.

The BVB's role "is to provide a marketplace for securities transactions, to enhance liquidity of securities by concentrating a large volume of supplies and demands to the market, to form fair prices that appropriately reflect such supply-demand relationship, and to distribute such prices to the public".

The BVB is both a market operator and a system operator. The BVB operates the Regulated Market, including a well-developed spot market and less-utilized derivatives market. The BVB also operates the RASDAQ market, which was initially an electronic market established based on the public pattern of the

1 See http://www.bvb.ro.

American NASDAQ and which for a very long period holds an uncertain legal regime, without being qualified as a regulated market, whilst some of the legal provisions applicable to the regulated market are also applicable to RASDAQ.

On the RASDAQ market, there are listed many Romanian companies which have undergone a privatization process in the 1990s. It is envisaged that by the end of 2012 the RASDAQ listed companies which have the best performance will be transferred to the Regulated Market operated by the BVB, while the rest of the companies will be included in the Alternative Trading System (ATS) which also is operated by the BVB in its capacity as system operator.

The most recent initial public offering within the BVB was that of *Fondul Proprietatea* (Property Fund), a *sui generis* closed-end investment company which was established by the Romanian State with a view to indemnify past owners which had been expropriated by the Communist regime in the late 1940s and 1950s. Fondul Proprietatea has a capitalization of approximately €4 billion**.**

The Sibiu Stock Exchange (SIBEX) is the second Romanian stock exchange and was known as the Monetary Financial and Commodities Stock Exchange in Sibiu (BMFM). SIBEX was established in 1994 but was only authorized by the CNVM as a market operator in 2003. As with the BVB, SIBEX is a market operator and a system operator, operating a regulated market and an alternative trading system. Contrary to the BVB, the strongest market operated by SIBEX is the derivatives market. In 1997, it launched the first derivatives products, futures contracts. In 1998, options on futures were implemented; in 2009, CFDs (contracts for difference); in 2010, shares; and, in 2011, binary options.

Transborder Electronic Trading Systems. Pursuant to the Capital Market Law, the central depository is a legal person, established as a joint-stock company, authorized and regulated by the CNVM, which performs deposit operations in connection with securities, as well as other related operations. The central depository also carries out clearing and settlement operations in relation to securities transactions.

The BVB and SIBEX have their own central depositories, which perform all the relevant operations provided by the law for the transactions taking place on the respective markets. The Central Depository[2] (*Depozitarul Central*) is a privately owned company controlled by the BVB as its majority shareholder. It was founded and started its activity in 2007 and is a member of the European Central Securities Depositories Association (ECSDA).

Crossborder transactions have only recently been implemented, mainly by means of bilateral agreements between the Central Depository and other depositories in Europe and the United States. The Central Depository established a direct connection with Clearstream Banking Luxemburg in 2009 (which only allows trading of bonds issued by the European Bank for Reconstruction and Development). The Central Depository has crossborder connections with 18

2 See http://www.roclear.eu.

countries (South Africa, Austria, Belgium, Czech Republic, Denmark, Switzerland, France, Germany, Greece, Ireland, Luxemburg, the United Kingdom, The Netherlands, Poland, Spain, the United States, Sweden, and Hungary) and provides the possibility of settlement operations in 11 foreign currencies.

Off-Market Transactions. The Over-the-Counter (OTC) system is not widely functional in Romania, despite public pressure from the largest investment firms on the market. The Romanian regulatory framework allows over-the-counter transactions, but such transactions are not practically possible due to the lack of rules issued by the Central Depository, which would be necessary for the transactions to be effectively implemented.

A single OTC transaction was performed in January 2012 (and it only involved shares of a foreign issuer primarily listed on a foreign market and listed on the BVB) since January 2012, approximately 20 over-the-counter transactions have been concluded. The Central Depository has approved rules implementing OTC turnaround transactions, which also must be approved by the CNVM before becoming applicable.

Securities

National Treatment and Reciprocity. The admission requirements for securities are determined by each market or system operator (BVB or SIBEX), by means of their internal regulations (which need to be approved by the CNVM, in order to enter into force). The Capital Market Law only states some general principles as regards admission to trading on a regulated market and states that securities which do not qualify for being admitted to trading on a regulated market may be admitted to trading on an alternative trading system.

Market and system operators are responsible for adopting specific regulations regarding the requirements for admission to trading. The CNVM issues regulations regarding the admission to trading on a regulated market of securities issued by non-residents. The general principle remains that the admission to trading on a regulated market can only be performed subject to the publication of a prospectus pre-approved by the CNVM.

Issuer Requirements. Pursuant to the Capital Market Law, in order for an issuer's securities to be admitted to trading on a regulated market, the issuer must observe the following requirements:

- The company must be established and function in accordance with the legal provisions;
- The company must have an anticipated capitalization of at least €1 million in RON equivalent or, to the extent that the capitalization cannot be anticipated, the capital and reserves, including profit and loss from the last financial year, of at least €1 million equivalent in RON calculated according to the National Bank of Romania exchange rate, at the date of application for admission to trading; and

- The company must have functioned for the last three years prior to application for admission to trading and must have drafted and submitted financial statements for that period, in accordance with the legal provisions.

Subject to obtaining an approval from the CNVM, the above-mentioned requirements may be circumvented, in case it is recognized that:

- There will be an adequate market for such shares; and
- The issuer will be able to fulfill the continuous and periodic information requirements arising from the admission to trading, and investors will have the necessary information in order to knowingly evaluate the company and shares admitted to trading.

The BVB Code (the internal regulation, approved by the CNVM, which regulates the organization and functioning of the BVB) provides more details with regard to the conditions that must be observed by the issuers, depending on the specific category in which the securities are intended to be traded. For example, in order for the issuer to trade shares on the first category of the Regulated Market, it must:

- Be a company which has completed a public offer for sale of shares, in order to be admitted to trading, under an offer prospectus approved by the CNVM or a company that has a prospectus prepared for the purpose of being admitted for trading, approved by the CNVM;
- Submit to the BVB, through the initiating company, all required documents;
- Pay all the charges due to the BVB, in accordance with its rules, and have no debts towards the BVB;
- Appoint two individuals to maintain a permanent contact with the BVB;
- Adhere to the conditions and terms of admission and maintenance of shares trading commitment;
- Own capital value from the last financial year of at least of €30 million in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB or have anticipated capitalization of at least of €30 million in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB;
- Have gained net profit in the last two years of activity;
- Present a business plan for at least the next three calendar years; and
- Submit to the BVB a presentation memorandum with its informational structure approved by the BVB Council.

Second-category issuers must own capital value from the last financial year to be at least €2 million in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB or have anticipated capitalization to be at least €2 million

in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB.

A third-category issuer must be a innovative and dynamic company with growth potential, have, in principle, in its business activity the development and implementation of new technologies in areas such as medicine, biotechnology, agriculture technology, telecommunications, and computer technology, and own capital value from the last financial year of at least €1 million in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB or have anticipated capitalization of at least €1 million in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB.

In the case of bonds issued by companies, public authorities, or international bodies, it is necessary for the issuer to be set up and perform its activity in compliance with the relevant legislative framework. For shares which will be admitted to trading on the international category of the Regulated Market, besides the general conditions to be observed by all issuers, the issuer must own capital value from the last financial year to be at least €1 million in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB or have anticipated capitalization to be at least €1,000,000 in RON equivalent, calculated at the National Bank of Romania exchange rate from the date of request for admission to trading submitted to the BVB.

Securities Requirements. In accordance with the Capital Market Law, shares that are to be admitted to trading on a regulated market must be freely negotiable and fully paid. In order for their admission to trading to be approved, a sufficient number of shares must be distributed to the public. Such sufficient number of shares is deemed to have been distributed if:

- Shares in respect of which the application for admission has been made are distributed to the public to the extent of at least 25 per cent of the subscribed capital, represented by this category of shares; and
- Proper market operation is ensured, with a lower percentage of shares than that provided in subparagraph a), due to the large number of shares put into circulation and to their allocation to public.

The request for admission to trading must be made with regard to all the shares of the same class that have been issued at the date of the request. In the case of bonds to be admitted for trading on a regulated market, the minimum amount of the issuance is €200,000 in RON equivalent. This requirement is not applicable to continuous issuances and, if approved by the CNVM, if it is considered that, for the respective bonds, an orderly market exists. Convertible bonds may be admitted to trading on a regulated market provided that the securities in which they can be converted are themselves already listed on a regulated market.

The CNVM may exempt bonds from this condition if it considers that investors have all the necessary information to form an opinion regarding the value of the shares into which the bonds would be converted. According to the BVB Code, shares to be admitted to trading on the Regulated Market, on the first, second, and third categories, must be:

- Registered with the CNVM;
- Freely transferable, fully paid, issued in dematerialized form, and highlighted with book entry;
- In the same class and the public spread of shares to be at least 25 per cent.

First-category shares also must be publicly distributed to at least 2.000 investors.

Prospectus Requirements. As mentioned above, the general rule resulting from the Capital Market Law (and from the Prospectus Directive) is that admission to trading on the regulated market can only be made further to addressing a request to the relevant market operator, after publishing a prospectus already approved by the CNVM. The procedures for the purpose of admission to trading on a regulated market must be performed by means of an intermediary. The obligation to publish a prospectus and to resort to an intermediary will not be applicable for the admission to trading of the following types of securities:

- Shares representing, in a period of 12 months, less than 10 per cent of the shares of the same class already admitted to trading on the same regulated market, provided that a simplified prospectus is available;
- Shares issued for substitution of other shares, of the same class, already admitted to trading on the same regulated market, if this new issue of shares does not imply a capital increase and provided that a simplified prospectus is made available;
- Securities offered in connection with a public takeover offer of exchange, provided that a document is available containing information considered by the CNVM as similar to the information contained in the public sale offer;
- Securities offered, allocated, or to be allocated, in connection with a merger, provided that a simplified prospectus is made available;
- Shares offered, allocated, or to be allocated, freely to existing shareholders, as well as issued shares where dividends are paid by the issuance of shares of the same class for which dividends are paid, provided that such shares are in the same class with the shares already admitted to trading on the same regulated market and that a simplified prospectus is made available;
- Securities offered, allocated, or to be allocated, to current or former members of management or employees of a company admitted to trading on a regulated market or one of its subsidiaries, provided that such securities are in the same class with securities already admitted to trading on the same regulated market and that a simplified prospectus is available;

- Shares arising from the conversion or exchange of other securities or the exercise of rights conferred by other securities, provided that such shares are in the same class with shares already admitted to trading on the same regulated market and that a simplified prospectus is made available;
- Securities already admitted to trading on other regulated market, observing the following cumulative conditions: (a) such securities or securities of the same class were admitted to trading on that regulated market for more than 18 months; (b) the prospectus under which the admission to trading of securities for the first time was performed was published with the observance of the law; (c) for securities admitted to trading for the first time, the prospectus drafted for admission to trading was approved as per the applicable EC law; (d) the company observed its reporting obligations due to the fact that securities are admitted to trading on that regulated market; (e) the person requesting admission to trading of securities on a regulated market in Romania drafted a brief document available to the public in Romanian language and which contains required information; (f) the document referred to in item (e), above, is available to the Romanian public; and (g) the document referred to in item (e), above, will contain the information comprised in the summary of a public offer prospectus, as well as information regarding where the latest available prospectus can be obtained and where the financial reports published by the issuer are available; and
- Shares offered, allocated, or to be allocated, in connection with a change in the capital of a company whose shares are admitted to trading on the same regulated market, provided that a simplified prospectus is made available.

After its approval, the prospectus must be made available to the public. A prospectus is deemed available to the public if:

- It may be obtained by a potential investor, free of charge, in a printed form, at least at the premises of the issuer and of the intermediary of such offer, or at the head office of the operator of the regulated market where the securities are admitted to trading;
- It is published in an electronic form on the issuer's web site and on the intermediary's web site;
- It is published in electronic form on the web site of the market operator, on the market where admission of such securities to trading is sought; and
- It is published in electronic form on the website of the CNVM, if it has decided to provide this service.

The prospectus must contain all information which, according to the particular nature of the issuer and of the securities offered to the public, is necessary to enable investors to make an informed assessment of: the assets and the liabilities, financial position, profit and loss, and prospects of the issuer and of any guarantor to the fulfillment of the obligations undertaken by the issuer, if necessary, and of the rights related to such securities.

In the case of a foreign issuer from an EU Member State, the shares of which are already admitted to trading on an EU-based regulated market, the prospectus approved by the regulatory authority from the respective EU Member State also is valid for the admission to trading on a regulated market in Romania, provided that the foreign regulatory authority notifies the CNVM.

In the case of an issuer from a third state, the CNVM will approve the prospectus which is drafted based on the legislation of the respective third state if the prospectus is drafted in accordance with international standards set by international organizations of securities commissions and contains information observing IOSCO transparency and information requirements, including those of financial nature equivalent to those required under the provisions of this Regulation. According to the Capital Market Law,[3] the liability for the veracity, preciseness, and accuracy of the information enclosed in the prospectus/bid document rests with:

- The bidder;
- The members of the bidder's board of directors;
- The issuer;
- The members of the issuer's board of directors;
- The founders, in case of public subscription;
- The financial auditor that certified the annual financial statements;
- The intermediaries of the offer; and
- Any other entity that assumed liability for the information in the prospectus.

Corporate Governance. Under the Romanian legislation, only joint-stock companies may be admitted to trading on a regulated market. Joint-stock companies can be subject either to a one-tier administration system (where the company would have a board of directors with mainly supervisory powers and one or more managers holding executive attributions) or to a two-tier system (in which supervision is performed by the supervisory board and managers are grouped in a management board).

Listed companies are obliged to audit their annual financial statements and their consolidated financial statements, where applicable. Directors and managers are obliged to present the shareholders precise and true information with regard to the economical standing of the company. Shareholders that do not agree with the company's decisions as regards mergers or spin-offs, resulting in the allocation of shares that are not admitted to trading on a regulated market, have the right to retire from the company and to obtain the value of their shares from the company.

Certain decisions to be adopted by the general meeting of shareholders (GMS) — as regards share capital increase through contributions in kind or regarding

3 Capital Market Law, art 182.

the waiver of the shareholders' preference right for the subscription of new shares — may be passed only with the observance of very strict requirements of quorum and voting majority, which practically make them impossible to be adopted.[4]

The shareholders have the right to participate in the GMS by simple proof of their identity. Shareholders also may be represented in the GMS by other shareholders or by other natural persons, not having a shareholder capacity, on the basis of a special power attorney, which must mandatorily include the vote to be expressed for each point of the agenda of the GMS.

Companies which are admitted to trading on the first category of the regulated market operated by the BVB must comply with at least 14 of the 19 principles enclosed in the Corporate Governance Code of the BVB. In their annual report, companies listed on the first category of the BVB must include a distinct section whereby they must confirm their compliance with the principles of the BVB's Corporate Governance Code, or provide explanations for their non-compliance with some of the principles thereof (as stated, not more than five).

Reporting. Companies which have their shares admitted to trading on a regulated market must observe certain reporting (disclosure) obligations, prescribed by the Capital Market Law and by Regulation Number 1/2006. The main reporting obligations can be classified into periodical disclosing and *ad hoc* disclosing.

Issuers of securities which are registered with the CNVM must submit to the CNVM the relevant reports, in electronic format, with electronic signature or, if the case, in hard copy. Reporting obligations are ceased at the moment of deregistration of the securities from the CNVM's registry. Issuers must make public the availability of all the required reports. The CNVM has the right to request additional information and documents from issuers, for the purpose of verifying, clarifying, or completing the reports. Furthermore, the CNVM may request to the issuer that it amends the relevant reports. In order to ensure that the investors are informed, the CNVM publishes the reports of the companies which are admitted to trading on a regulated market on its own website.[5] The issuer must submit to the CNVM, the market operator, and make available to the public, within four months as of the end of the financial year, the annual report which must include:

- Annual financial statements, audited, and approved by the competent corporate body;
- Report of the board of directors or equivalent;

4 In both cases, the quorum requirement is for at least three-quarters of the total number of shareholders to participate in the GMS which, in the case of a listed company, is practically impossible to fulfill, given the very large number of shareholders of these companies.

5 See http://www.cnvmr.ro.

- Statement of the responsible persons whereby it is stated that the annual financial statements reflect in a true and precise manner the assets, liabilities, financial standing, and profit and loss account of the issuer and of the subsidiaries included in its scope of consolidation; and
- Financial auditor's report.

The issuer must file a half-yearly report for the first semester of the financial year. The report will be submitted to the CNVM and the market operator and will be made available to the public within two months as of the lapse of the first semester.

The half-yearly report must include the half-yearly accounting report, drafted based on the applicable legislation, report of the board of directors; statement of the responsible persons, whereby it is stated that the half-yearly financial statements reflect in a true and precise manner the assets, liabilities, financial standing, and profit and loss account and that the report of the board of directors truly and completely reflects the information regarding the listed company; and report of the financial auditor and its full comments, in case the half-yearly financial statements have been audited.

The issuer must file a quarterly report for the first and third quarter of the financial year. The report will be submitted to the CNVM and the market operator and will be made available to the public within 45 days as of the lapse of the relevant trimester. The report must include the profit and loss account, as well as other financial indicators; the report of the financial auditor and its full comments, in case the quarterly financial statements have been audited; and, optionally, the report of the board of directors.

Pursuant to the Capital Market Law,[6] an issuer must inform the public and the CNVM, with no delay, as regards privileged information which directly concerns it. The information must be notified to the public, the stock exchange, and the CNVM within 24 hours from its occurrence, and it is published in the electronic bulletin of the CNVM. Privileged information includes (without being limited to) the following:

- Resolutions of the board of directors or other bodies, on the summoning of the general meeting of shareholders or holding a board of directors' meeting in order to deliberate for the exercise of the GMSs' attributions delegated to the board of directors;
- Summoning of the GMS;
- Resolutions of the GMS or of the board of directors, regarding the exercise of attributions delegated by the GMS;
- Changes in control of the company, including changes in control of the entity that controls the company;
- Changes in the management of the company;

6 Capital Market Law, art 226.

- Replacement of the company's auditor and reasons which lead to this replacement;
- Termination or decrease of contractual relations which generated at least 10 per cent of company revenues in the previous financial year;
- Publication of merger or spin-off project in the *Official Gazette*;
- Changes in the characteristics and/or rights for different classes of securities, including changes in rights attached to the issuer's derivatives conferring rights on shares issued by it;
- Litigation involving the company;
- Initiation of a termination or resuming of activity procedure, initiation and closing of the dissolution procedure, reorganization, or bankruptcy; and
- Off-balance-sheet operations with significant effects on the issuer's financial results.

Reports regarding the EGMS decision on mergers and spin-offs, changing the main scope of business of the issuer, movement of the statutory office or changing the legal form of the company, as well as the withdrawal from trading on the regulated market also must be published in a national newspaper.

Reports on any major new developments in the issuer's sphere of activity and which may lead to substantial movements in the prices of its shares must be submitted to the CNVM and the market operator within maximum 48 hours as of the occurrence of the event and are published in at least one national newspaper. The information includes, without being limited to, the following:

- Changes in the company's obligations that can significantly affect the activity or the patrimonial standing of the company;
- Acquisitions or disposals of substantial assets;[7]
- Contracts whose value exceeds 10 per cent of net turnover for the last annual financial accounts or contracts concluded outside of the company's current activity; and
- Development of a product or introduction of a new service or a development process that affects the company's resources.

At the request of shareholders which hold at least five per cent of the shares of an issuer, the financial auditor of the issuer is obliged to draft a report with regard to the operations and transactions indicated by the respective shareholders. The directors of the issuers are obliged to provide information to

7 The term "acquisition" refers not only to purchases, but also includes procurement such as leasing or any other way of obtaining assets. Similarly, the term "disposal" does not refer only to sales, but may include leasing or exchange contracts, as well as abandon or destruction of assets. Acquisitions or disposal of assets will be considered substantial if the assets represent at least 10 per cent of the total value of the company's assets either before or after the transaction.

the financial auditor. The report must further on be submitted to the CNVM and the market operator within maximum 30 days as of the receipt of the request by the financial auditor. The report will be made public on the CNVM's website.

Prior to the date on which dividends will be paid, the issuer is obliged to publish a press release in a national newspaper which must indicate the value of the dividend per share and the due date for payment, as laid down by the EGMS and payment methods and, if the case, identification data of the payment agent.

Directors of listed companies are compelled to report, with no delay, any legal deed concluded by the company with its directors, employees, shareholders holding control over the company, as well as with any other persons involved with them, in case the value of the legal deed is at least equal to €50,000 in RON equivalent. Reports must be submitted to the CNVM and the market operator within five days as of concluding the legal deed and will be published in the CNVM's bulletin. Provided that listed companies conclude such legal deeds with companies from their own group on a regular basis, they will be permitted to file the report on a monthly basis, indicating the list of the intra-group agreements concluded in the respective month.

Trading Rules

Securities Offerings

Public Offer

Performance of public offers through the trading system of the market operator or system operator is regulated by CNVM Instruction Number 3/2007, while other relevant provisions are included in the BVB Code. Subscriptions made in a public purchase/sale offer must be performed only with the strict observance of the conditions laid down in the prospectus/bid document approved by the CNVM.

Intermediaries (intermediaries are credit institutions and investment firms authorized as such) have the obligation to inform the investors with regard to the conditions of performing the offer and are responsible for the observance of the provisions of the prospectus/bid document. At the moment of filling in the order sheets, intermediaries must verify the compliance with the provisions of the prospectus/bid document and they certify such compliance by placing the orders enclosed by the order sheets in the trading system of the market operator.

The intermediary of the offer, the intermediaries involved in the unwinding of the offer, the bidder, and the market operator bear the liability regarding the operations performed during the offer, each according to its attributions. However, the responsibility for setting out the allocation index is borne exclusively by the intermediary of the offer. Allocation is made subsequent to the closing date of the offer, as per the provisions of the prospectus/bid document. The settlement will be performed at T+3, where T is the date of the transactions afferent to the offer. The transfer of the ownership of the financial

instruments (except for securities) is performed at the date of settlement, based on the principle of delivery versus payment.

Place of Order

According to the BVB Code, financial instruments which are subject to a public offer must be traded on the Offer and Special Operations Markets. Offer and Special Operations Markets are classified into primary public sale offers, secondary public sale offers, secondary public purchase offers, special "sales at order", and other methods of transferring ownership over financial instruments.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties

The Capital Market Law[8] provides for the persons who acquire or dispose of securities of a listed company, resulting in a shareholding which exceeds or falls below five per cent, 10 per cent, 20 per cent, 33 per cent, 50 per cent, 75 per cent, or 90 per cent of the total number of voting rights, an obligation to report such acquisition or disposal to the company, the CNVM, and the market operator. The report must be submitted within a maximum of three business days as of the acquisition/disposal.

Company Duties

In addition to the report submitted by the acquirer, mentioned above, the company whose securities were acquired must make the information on the acquisition public within three days as of the moment when it has been informed with regard to the acquisition.

Insider Trading and Fraud

Basis of Territorial Link

The provisions regarding market abuse and the regime of privileged information are a very precise transposition of the corresponding provisions of the Market Abuse Directive and the directives which implement it. Pursuant to the Capital Market Law, any issuer must inform the public and the CNVM, with no delay, as regards the privileged information which directly concerns it.

However, an issuer is allowed to delay the public disclosure of the information, in case it would harm its own interests, on the condition that such deferral does not mislead the public and that the issuer may ensure the confidentiality of the information. The issuer must immediately inform the CNVM in connection with the deferral of disclosing the information and the CNVM may oblige the issuer to disclose the information, in order to ensure the transparency and integrity of the market.

8 Capital Market Law, art 228.

Issuers or persons acting in their name or on their behalf must draft a list of persons working for them which have access to privileged information. The list shall be regularly updated and submitted to the CNVM, upon request. “Inside information” is defined as information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

In relation to derivatives on commodities, “inside information” will mean information of a precise nature which has not been made public, relating, directly or indirectly, to one or more such derivatives and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practices on those markets. For persons charged with the execution of orders concerning financial instruments, ‘inside information’ shall also mean information conveyed by a client and related to the client's pending orders, which is of a precise nature, which relates directly or indirectly to one or more issuers of financial instruments or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

Information will be deemed to be of a “precise nature” if it indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and whether it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments.

"Information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments" will mean information a reasonable investor would be likely to use as part of the basis of his investment decisions. “Market manipulation” will mean:

- Transactions or orders to trade which give, or are likely to give, false or misleading signals as to the supply of, demand for, or price of financial instruments or which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level, unless the person who entered into the transactions or issued the orders to trade establishes that his reasons for so doing are legitimate and that these transactions or orders to trade conform to accepted market practices on the regulated market concerned;
- Transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance;
- Dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumors and false or

misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading;

- Conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument which has the effect of fixing, directly or indirectly, purchase or sale prices or creating other unfair trading conditions, or the buying or selling of financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices; or
- Taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument (or indirectly about its issuer) while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way.

It is prohibited for any person who possesses inside information to use that information by acquiring or disposing of, or by trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates. It also is prohibited to disclose privileged information to any other persons, except for when the disclosing has been performed in the normal course of business or in consideration of its duties. Moreover, persons possessing inside information are forbidden to recommend or induce another person, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates. Breach of the above-mentioned provisions on illegal use of inside information or market manipulation is considered a criminal offence and is punished with imprisonment from six months to five years or criminal fine.

Extraterritorial Application

As a general rule, stated by the Capital Market Law, the provisions of the Capital Market Law are only applicable to operations performed in Romania. However, there are specific provisions regulating possible extraterritorial application issues as regards market abuse aspects.

Pursuant to article 253 in the Capital Market Law, provisions regarding market abuse (which include use of inside information and market manipulation) will be applicable to any financial instrument admitted to trading on a Romanian regulated market or on a regulated market of an EU member state, or for which a request for admission to trading has been filed, irrespective whether the transaction occurred on the respective regulated market or not.

The provisions also will be applicable to any other financial instrument which has not been admitted to trading on a Romanian regulated market or on a regulated market of an EU member state, but whose value is dependent on the value of a financial instrument which has been admitted to trading on a

Romanian regulated market or on a regulated market of an EU Member State, or for which a request for admission to trading has been filed. Paragraph (3) of article 253 states that the provisions related to inside information and market manipulation also will apply to:

- Operations performed in Romania or abroad, with financial instruments admitted to trading on a regulated market which is situated or operates in Romania, or for which a request for admission to trading on the respective market has been filed; and
- Operations performed in Romania with financial instruments admitted to trading on a Romanian regulated market or on a regulated market of an EU member state, or for which a request for admission to trading on the respective markets has been filed.

The Capital Market Law adds that the CNVM is the only authority competent to enforce the provisions regarding inside information and market manipulation, provided that the conduct occurs in the conditions described by the Capital Market Law. The CNVM has the attribution to take any necessary measures and impose any relevant sanctions to the persons responsible for such breaches.

Public Take-Over Bids

Territorial Application (Foreign Bidder-Domestic Target)

Regulation Number 1/2006 includes specific provisions on takeover bids with extraterritorial elements (defined as crossborder bids). Where securities issued by the target company headquartered in Romania are not listed on a Romanian regulated market, the authority competent to approve the bid document and/or to supervise the bid is that of the EU member state where the regulated market is located.

The authority competent to approve the bid document and/or to supervise the bid is that of the EU member state where the target company is registered, if the securities are listed on a regulated market located in the respective member state. Where securities issued by a target company headquartered in another EU member state are only listed on a regulated market located in Romania, the CNVM will be competent to approve and supervise the bid.

Where securities issued by a target company are listed on multiple regulated markets located in Romania and in other EU Member States, the authority competent to approve the bid document and/or to supervise the bid is that of the state where the securities had been listed first.

Procedural Requirements

The general rule stated by the Capital Market Law is that any person who intends to make a public offer (bid) must previously submit to the CNVM a request for approval of the prospectus (in case of public sale offers) or of the bid document (in case of public purchase offers). Further to the approval of the

prospectus or of the bid document, this must be made available to the public, no later than the initiation of the public offer. Except for contrary provisions of the law, any public offer performed in the absence of an approved prospectus/bid document or by breaching the conditions laid down in the decision of approval is void and may cause sanctions to be applied to the responsible persons.

The public offer notice may be launched at any moment after the approval of the prospectus/bid document by the CNVM and must be published in at least two national daily newspapers. The public offer notice will enclose information regarding the specific ways in which the prospectus/bid document is available to the public. The prospectus will be deemed available to the public if it:

- It is published in at least one printed newspaper or online, in compliance with European regulations as regards the content and publication of prospectuses, as well as advertising dissemination;
- Can be obtained free of charge, on paper, by a potential investor, at least at the premises of the bidder or broker, or at the premises of the market operator where the securities are admitted to trading;
- Is published on the bidder's and broker's website;
- Is published on the market operator's website; or
- Is published on the CNVM website, if the CNVM has decided to offer that service.

All advertising items related to a public offer must be pre-approved by the CNVM. The occurrence of a new event or the amendment of the information initially enclosed in the prospectus/bid document which is likely to affect the investors' decision must be inserted in the prospectus and must be approved by the CNVM within seven days. As a classification, public offers are divided by the Capital Market Law into four categories, namely:

- Public sale offers;
- Public purchase offers;
- Voluntary takeover bids; and
- Mandatory takeover bids.

Public purchase offers are defined as the offer to buy securities made by a person and addressed to all holders of the respective securities, broadcast through the intermediary of mass media or other specific means, but on the condition that it can be equally received by all securities holders. The public purchase offer must be performed through an authorized intermediary (ie, a credit institution or an investment firm) and must ensure equal treatment for all investors.

Voluntary takeover bids are public purchase offers whereby a person who is not obliged to do so addresses an offer to all securities holders, for their entire holdings, with a view to acquiring more than 33 per cent of the voting rights. In

order to perform the voluntary takeover bid, the acquirer must submit to the CNVM a preliminary notice.

After the approval by the CNVM, the preliminary notice must be submitted to the target company, to the regulated market and will be published in at least one national newspaper and one local newspaper. Subsequent to the receipt of this preliminary notice, the board of directors is prohibited from concluding any legal deed or taking any measure which would impact the patrimonial state of the target company. The voluntary bidder is obliged to submit the voluntary takeover bid to the CNVM within 30 days as of publishing the preliminary notice.

Mandatory takeover bids must be made in the case where a person, further to its acquisitions alone or together with other persons acting in concert, holds more than 33 per cent of the voting rights of a listed company. In such case, the respective person is obliged to launch a takeover bid, addressed to all holders of the respective securities and for their entire participations, within two months as of exceeding the 33 per cent participation.

Further to performing a voluntary or mandatory takeover bid, the bidder has the right (and the investors have a corresponding obligation) to require those investors which did not subscribe during the bid to sell their shares for a fair price, if at least one of the bidders owns more than 95 per cent of the target company's share capital or the bidder acquired, during the previous bid, more than 90 per cent of the available shares. Where a mandatory or voluntary takeover bid occurred and the bidder resulted in owning more than 95 per cent of the target company's share capital, minority shareholders are entitled to request the majority shareholder to buy their shares in exchange for a fair price.

Exemptions

The obligation to publish a prospectus in case of public sale offers is generally applicable, save for certain exemptions provided by the relevant legislation.[9] Exemptions apply to offers addressed only to qualified investors, provided that a simplified prospectus is made available; offers addressed to less than 100 investors, natural or legal persons, other than qualified investors, provided that a simplified prospectus is made available; securities offers addressed to investors who purchase each, within the offer, securities of at least €50.000 in RON equivalent, provided that a simplified prospectus is made available; securities offers whose nominal value per unit is of at least €50,000 in RON equivalent, provided that a simplified prospectus is made available; and securities offers whose total value, in a period of 12 months, is less than €100,000 in RON equivalent, provided that a simplified prospectus is made available.

Exemptions apply to securities offered, allocated, or to be allocated, in connection with a merger, provided that a simplified prospectus is made available; securities offered, allocated, or to be allocated, freely to existing

9 Regulation Number 1/2006, art 15, para (1).

shareholders, where dividends are paid by issuing new shares, in the same class with the shares for which the dividends are paid, provided that a simplified prospectus is made available; shares issued for the substitution of other shares, in the same class, already issued, if this new issuance of shares does not imply a share capital increase, provided that a simplified prospectus is made available; securities offered in exchange of other securities subject to a public sale/exchange offer, provided that a simplified prospectus is made available; securities offered, allocated, or to be allocated, to actual or former members of management or to employees of a company, or one of its subsidiaries, whose securities are already admitted for trading on a regulated market, provided that a simplified prospectus is made available; and shares offered, allocated, or to be allocated, in connection with a change of the share capital, other than share capital increase by cash, by free allocation of shares to current shareholders or as a result of payment of dividends by issuing new shares in the same class with the shares for which the dividends are paid, provided that a simplified prospectus is made available.

As to the obligation to carry out a mandatory takeover bid, certain exemptions are provided by the Capital Market Law. A mandatory takeover bid need not be carried out where the holding of more than 33 per cent of the target's shares was acquired further to an exempted transaction. Pursuant to the Capital Market Law, exempted transactions represent the acquisition of the holding by means of the privatization process, acquisition of shares from the Ministry of Public Finance, or other legally authorized entities, in the context of enforcing budgetary receivables, transfer of shares between a parent-company and its subsidiaries or between the subsidiaries themselves, and where a voluntary takeover bid has been performed.

Jurisdiction Conflicts

The general rule stated by the Capital Market Law is that it is applicable to the incorporation and functioning of financial instruments and markets and the activities and operations specific to those markets which are performed in Romania. The CNVM is the only competent authority to enforce the provisions of the Capital Market Law.

As to private international law regulations, the New Civil Code stipulates that the capacity of a legal person is governed by the law of its organic statute, which is the national law of the legal person, defined as the law of the country where the legal person is headquartered. Specific provisions refer to collaterals over shares, where it is stated that in case of shares which are traded on an organized market, the law of the country where the organized market is located will be applicable. The Capital Market Law states that, with regard to the breaches of provisions concerning market abuse, inside information regime, and market manipulation, the CNVM is the only authority competent to ensure the application of these provisions.

Russia

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Russia

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Introduction

Regulatory System

In General

Russian law does not have a term equivalent to the notion of 'security' in the Common Law. The definition of a valuable paper (*tzennaya bumaga*), which is sometimes translated as 'security', is far more general in comparison with a Common Law 'security', ie, a special type of investment interest. In this respect, Russia belongs to those legal systems in which the regulation on 'valuable papers' applies to numerous types of documents, including investment securities. Russian legislation relating to valuable papers in general is applicable directly or implicitly to investment securities.

The notion of valuable papers also includes various commercial papers, negotiable instruments, documents of title, and other commercial instruments which meet established requirements. Several attempts were made in the 1990s to legally define the concept of valuable papers and a class of valuable papers similar to securities. In 1990, the Regulation on Securities approved by Decree Number 590 of 19 June 1990 defined valuable papers as:

> . . . monetary documents certifying the vested interests or loan relations, which define the relations between a person issuing them and their holders and provide, as a rule, for distribution of yield as dividend or interest, as well as possibility to transfer monetary and other rights resulting from this documents to other persons.

With the adoption of the Russian Soviet Federative Socialist Republic (RSFSR) Regulation on Securities Issue and Circulation and Stock Markets in the Russian Federation, securities (valuable papers) were defined as:

> . . . monetary documents certifying the proprietary rights or the monetary claim of the document holder against the person issuing these documents.[1]

1 Confirmed by Regulation of the Government of the Russian Federation Number 78 of 28 December 1991, art 1, item 1.

A better definition was incorporated in the Fundamentals of Civil Legislation of the Soviet Union and Union Republics accepted by the Supreme Soviet of the USSR on 31 May 1991. According to item 1, article 31, of the Fundamentals, 'documents certifying proprietary rights which can be exercised only on presentation of originals of these documents are recognised as valuable papers'. The definition of securities effective at present is contained in the Civil Code of the Russian Federation, which describes valuable papers as the:

> . . . documents certifying, in compliance with the requirements as to them and necessary requisite elements, the proprietary rights, realisation, or transfer of which is possible only at sight of these documents.[2]

Investment Securities

The Law in the securities market (as amended by the Federal Law of 26 November 1998) defines the investment (issued) security as a valuable paper (security), including the non-documentary, which certifies the complex of property and non-property rights placed by issues where each security provides equal rights to the owner, regardless of when acquired. Investment securities are distinguished by the following features:

- They certify the complex of economic and non-proprietary rights which can be transferred and utilised in compliance with them and the procedure established by the special Federal Law;
- They are placed by issues; and
- Each paper of the issue is issued on the same terms, irrespective of the time when it is acquired.

An issue of securities is the series of securities of one issuer that give the same rights to their holders and are issued on the same terms (initial placement). All securities within the issue have the identical state registration Number. Investment securities and, under certain conditions, other securities also are subject to rules governing investment activity.[3]

The term 'securities market' is used to describe activity associated with securities issues and trade. The securities market is split in two parts, ie, primary and secondary. The primary market is for initial public offerings, ie, the sale of securities by an issuer to their first owners (investors); all subsequent transactions constitute the secondary market. One also may distinguish the 'organised' market, ie, floor trade in exchanges and electronic trading systems, and the unorganised (out-of-exchange) market. The stock market also can be classified as to the type of securities.

2 Russian Federation Civil Code, art 142.
3 Federal Law Number 1488-1 (as amended) of 26 June 1991, arts 1 and 3; Federal Law Number 39-FZ of 25 February 1999, art 1.

Legal Sources

Russia is a Civil Law jurisdiction where legislation is the most important source of law. The Constitution and the Civil Code are two primary sources of law. Securities transactions are governed by a number of regulations subordinate to the Civil Code. The following statutes lay down the framework of Russian securities regulation:

- The Civil Code of the Russian Federation (Parts 1 and 2);
- The Law on Joint-Stock Companies of 31 December 1995;
- The Law on Protection of Rights and Lawful Interests of Investors at the Securities Market of 5 March 1999 (hereinafter, the Law on Investors' rights); and
- The Law on Securities Market of 22 April 1996.

Federal Law Number 39-FZ of 22 April 1996 and the Law on Investors' Rights define not only the status of investment securities as instruments certifying certain economic and other related interests, but also many aspects of transactions with such securities and regulatory compliance. The Securities Market Law is a blanket regulation. It provides for adoption of delegated legislation, as developed by the Federal Securities Market Commission, the Central Bank, and the Finance Ministry.

Rules relating to securities also are found in the Russian Federation Criminal Code.[4] Federal Law Number 119-FZ of 21 July 1997, in articles 51 and 59, establishes a special procedure for the arrest of and execution against securities.[5] The Budget Code[6] includes a section devoted to public debt, including regulation of government and municipal securities and guarantees.

Certain legislation is devoted exclusively to a particular group of instruments (eg, government and municipal securities or registered stocks) or securities of a particular kind (eg, shares, promissory notes, and bills of exchange).[7]

Authorities

Federal Securities Market Commission

In General. The Federal Securities Market Commission[8] is a federal body of executive power implementing the state policy as to the securities market, controlling the activity of professional participants and determining standards for securities issue. The principal functions of the Federal Securities Market Commission are summarised in article 42 of

4 Federal Law of 1 July 1996, as amended, arts 177, 184–187, 204, 290, and 304.
5 Government Decision Number 934 of 12 August 1998; Resolution Number 4 of 3 March 1999.
6 Federal Law Number 145-FZ of 31 July 1998.
7 Federal Law Number 136-FZ of 29 July 1998; Federal Law Number 48-FZ of 11 March 1997.
8 See http://www.fedcom.ru.

the Securities Market Law.[9] The functions of the Federal Securities Market Commission are legislative, organisational, and supervisory.

Legislative Function. The Federal Securities Market Commission regulates two principal aspects of securities market. It issues normative acts on placement and circulation of securities, ie, creates the rules applicable to securities themselves, and establishes standards of conduct applicable to parties to securities transactions, ie, issuers, intermediaries, and investors.

Central Bank of Russia

The second part of the 1990s were marked by the struggle between the Federal Securities Market Commission and the Central Bank over the competence to regulate securities issue and trading by the banks. The struggle was resolved in 1997 in a compromise by which the Federal Securities Market Commission formally remained the ultimate regulatory authority while the Central Bank received a general mandate to resolve all issues related to the involvement of banks in securities issue and trading. The banks also may engage in professional activities in the securities market subject to the licence issued by the Central Bank.

According to the Federal Law of 2 December 1990 on the Central Bank of the Russian Federation (Bank of Russia), as amended (the Central Bank Law), the Central Bank executes the functions of state management of the activity at the market of securities of credit organisations.[10] The Central Bank has normative, organisational, and supervisory powers, which follow from its general competence as a state body responsible for organisation of financial relations and control over them. In addition, in some cases, the law specifies the Central Bank functions relating to securities market. The Central Bank of the Russian Federation:

- Registers the issue of securities by credit organisations;[11]
- Establishes the terms of operation for cumulative accounts where the assets used by credit organisations for issuing shares are accumulated;[12]
- Establishes the procedure of formation and use of surplus funds, including the funds for possible securities appreciation;[13]

9 Decree Number 1009 of the President of the Russian Federation of 1 July 1996, as amended by Decree Number 456 of 12 April 1999, Decree Number 620 of 3 April 2000, and Decree Number 184 of 18 February 2002; Enactment Number 119 of the Government of the Russian Federation of 4 February 1997.

10 See http://www.cbr.ru.

11 Rules of Securities Issue and Registration by Credit Organisations at the Territory of the Russian Federation, Approved by the Instruction of the Central Bank of Russia Number 8 (with the changes from 17 September 1996); Central Bank Law, art 8, item 8.

12 Securities Market Law, art 27.

13 Enactment approved by the Letter of the Central Bank of Russia of 24 April 2000, Number 112-p; Banks and Bank Activity Law of 2 December 1990, art 24, with the changes introduced by the Federal Law of 3 February 1996, Number 17-FZ;

- Advises the Finance Ministry of the Russian Federation with the schedule of issue of state securities and redemption of the state debt in connection with their influence on the state of the bank system and priorities of the common state monetary and credit policy;[14]
- Issues loans for a term no longer than one year which back up securities and other assets, unless otherwise stated by the Federal Budget Law;[15]
- Buys and sells state securities at the market;
- Seconds a representative to participate in the work of the Federal Securities Market Commission Board;[16] and
- Reviews together with the Federal Securities Market Commission draft normative acts which specifically mention credit organisations, as well as regulations governing transactions with financial assets denominated in foreign currency (securities in foreign currency).[17]

Finance Ministry of Russia

The Finance Ministry exercises both general steering and specific technical functions in the securities market.[18] The Finance Ministry:

- Establishes rules for bookkeeping and statutory reporting for issuers and professional participants of the securities market (in co-operation with the Federal Securities Market Commission);
- Develops proposals on internal and external state borrowings of the Russian Federation;
- Issues state securities;
- Clears the total amount and conditions of issue of bonds of subunits of the Federation and other administrative and territorial formations;
- Takes part in the development of proposals on development of the securities market in the Russian Federation;
- Implements, together with the Central Bank of Russia, the state policy in the sphere of issue and placement of state securities;
- Registers issues of certain securities (notably, government and municipal securities); and
- Organises and provides for publication of securities forms.

State Commission on Protection of Rights of Investors on the Financial and Stock Markets of Russia

The State Commission on Protection of Rights of Investors on the Financial and Stock Markets of Russia ('State Commission') was formed in accordance with the Decree of the

14 Central Bank Law, art 19.
15 Federal Budget Law on the Order of Allotting Credits by the Central Bank of Russia to Banks on the Security of State Securities; Order of the Central Bank of Russia of 6 March 1998, Number 19-P; Central Bank Law, art 45.
16 Securities Market Law, art 41, part 3.
17 Securities Market Law, art 43, parts 6 and 7.
18 See http:/www.minfin.ru.

President of the Russian Federation Number 730 of 16 July 1997 (as amended) on the State Commission on Protection of Rights of Investors on the Financial and Stock Markets of Russia in implementation of the Decree of the President of the Russian Federation Number 416 of 26 April 1995 on Measures on Providing for Interests of Investors and Setting the Activity of Juridical Persons at the Financial and Stock Markets without Required Licences in Compliance with the Law of the Russian Federation and the Complex Program of Measures on Providing for Rights of Depositors and Shareholders, approved by the Decree of the President of the Russian Federation Number 408 of 21 March 1996.

The State Commission is a collegiate body whose activity is aimed at organisation of development and realisation of the system of state measures for Protection of Rights of Investors on the financial and stock markets of Russia.[19] The State Commission is subordinate and accountable to the President of the Russian Federation. The functions of the State Commission include:

- Co-ordination and control of the activity of federal bodies of executive power responsible for regulation of the activity on the financial and stock markets of Russia, in the sphere of protection of legal interests of investors;
- Development and realisation of measures on attraction of investments to the Russian economy and their protection, with priority given to foreign investments in an amount greater than US $100 million, as well as investments directed to the 100 largest enterprises of Russia;
- Analysis of the procedures of bankruptcy and liquidation of juridical persons, including banks, other credit organisations, and financial companies acting on the financial and stock markets of Russia, as well as analysis of supervision over safety of arrested assets and the order of their sale in the process of execution; and
- Analysis of the procedures of transformation of voucher (privatisation) investment funds into share investment funds, as well as the procedures of liquidation of juridical persons accumulating individuals' funds (performing investment activity), without the corresponding licence.

The State Commission has a right to audit compliance with investors' rights by organisations operating at the financial and stock markets of Russia; decisions of the State Commission are binding for the federal bodies of executive power which have representatives working in the Commission.

Legal Order and Regulatory Interests

Admission

Market Participants

In General. The main players in the securities market are companies issuing securities (issuers), as well as persons purchasing securities (investors). Intermediaries (agents)

19 Decree of 16 July 1997, Number 730.

facilitate capital circulation and creation of conditions for more efficient interaction between the issuer and the investor. Entities which render services on securities and capital markets as a main and/or exclusive activity, ie, professionally, are the professional participants in the securities market.

Article 1 of the Securities Market Law establishes special requirements applicable to professional participants. Article 2 of the Securities Market Law provides for the following general qualifications of professional participants of the securities market.

Only juridical persons or citizens registered as individual entrepreneurs can be professional participants in the securities market. Their activity must fall within the following categories:

- Brokering;
- Dealing;
- Managing securities;
- Clearing;
- Performing depository (custodial) functions:
- Maintaining securities holder registers; and
- Organising trade in securities.[20]

For some activities, the Securities Market Law stipulates additional requirements. For example, certain functions may only be carried out by legal entities incorporated as stock companies, while others may be carried out only by non-commercial entities. A professional registrar may not engage in any other professional activity in the securities market.[21]

Professional participants in the securities market should be distinguished from other intermediaries acting on this market. For instance, a commodity exchange may act as a non-professional intermediary in the securities market, because securities such as bill of lading are sold using the infrastructure provided by it.[22] Banks also can act as non-professional intermediaries when performing operations on collecting bills.[23]

Not every activity on the securities market qualifies as professional in the meaning of the Securities Market Law.[24] When a commercial company purchases securities, such as bills of exchange, bills of lading, or shares, and resells them to gain profit, such an activity is not qualified as professional. However, if the company routinely performs such operations on the instruction of third parties by a contract of commission or a contract of agency (broker's activity) or as a dealer, under certain conditions, it can be held liable for acting as a professional participant without the necessary licence. Article 38 of the Securities Market Law deals with prohibition and suspension of the activity of entities engaging in

20 Securities Market Law, arts 3–15.
21 Securities Market Law, art 10, part 1.
22 Law of the Russian Federation of 20 February 1992, Number 2383-1 on Commodity Exchanges and Exchange Trade, art 6.
23 Law of the Russian Federation on Banks and Banking Activity, arts 5 and 6.
24 Securities Market Law, arts 3–11.

business activity in the securities market without a corresponding licence.[25] Provision of services related to the securities market is deemed to be a financial activity. Therefore, the activity is subject to regulation by other special legislation, ie, on financial services.

Domestic Exchanges. Both exchanges and electronic trading systems are classified in Russian law as 'organisers of trade'. Certain requirements also apply to the stock exchange itself and its members.[26] The activity of a securities exchange, as well as securities departments of commodity exchanges and currency markets, requires a licence for the activity on organisation of trade in the securities market.[27]

The organisation of trade must be the exclusive activity of an entity, with the exception of depository services and activity on determination of mutual obligations (clearing) which are compatible with the status of securities exchange. Securities exchange renders services that directly facilitate the conclusion of civil law transactions with securities between the participants of the securities market.[28] The Securities Market Law does not provide an exhaustive list of functions, execution of which constitutes the securities exchange activity on organisation of trade at the securities market. The principal functions in practice are:

- Creation of conditions for assembly of professional participants of the securities market on the premises;
- Concentration of sell and buy offers; and
- Formation of a certain system (organisation) of trade in compliance with the special rules and regulations.

Securities exchanges are not major players on the Russian securities market. Their role is not so important in comparison to that played by the securities exchanges in foreign countries where these organisations provide the vehicle for significant financial transactions in the securities market.

Securities exchanges must be incorporated as non-profit partnerships.[29] This requirement does not apply to stock departments of commodity exchanges and currency markets.[30] Only members of the exchange are admitted to trading sessions. Other participants of the securities market can trade at a securities exchange only through its members. Special features of the functioning of a securities exchange as a non-profit organisation, including its rights and obligations towards its members, are established in articles 11–15 of the Securities Market Law and can be refined in local normative rules issued by the securities exchange. As a trade organiser in the securities market, a securities exchange is obliged to

25 Resolution by the Federal Securities Market Commission Number 50 of 23 November 1998; Resolution by the Federal Securities Market Commission Number 52 of 23 November 1998.
26 Securities Market Law, arts 11–13 and 39.
27 Securities Market Law, art 11, parts 1 and 3.
28 Securities Market Law, art 9.
29 Federal Law of 14 January 1996, Number 7-FZ on Non-Profit Organisations, art 8.
30 Securities Market Law, art 4, part 11.

provide information about its activity to any interested person. Evidently, this rule refers to not only securities exchange members, but also outsiders.[31]

Transborder Electronic Trading Systems. Electronic trading systems (save transborder ones) are at the very early stages of development in Russia. The first steps in this direction have already been made.[32]

In January 2000, the Federal Securities Market Commission adopted Recommendation Number IB-02/229 on Possible Fraudulent Securities Trading Schemes on the Internet, which alerts Russian users to fake Internet services offering brokerage and other services in overseas markets. These services are apparently specifically oriented to a Russian audience and offer Russian interface.

Off-Market Transactions. The organised market has existed for shares and bonds (debentures) only. However, the Federal Securities Market Commission has published provisions for organised trade on the debt market in *veskels* (promissory notes). According to published estimates, the daily turnover of unorganised trade in *veskels* (promissory notes) was estimated in January 2000 to have a nominal value of US $400 million to US $1 billion. The market itself was estimated to be worth US $21 billion.

The two leading organisers of trade, the Russian Trading System (RTS) and the Moscow Interbank Exchange, have expressed readiness to commence regulated trade in promissory notes when the corresponding legislation becomes effective. The rules for this market are developed by the Federal Securities Market Commission in cooperation with the Association of the Veskel Market (AUVER).[33]

Self-Regulatory Organisations. Self-regulatory organisations were formed in the early 1990s as private counterparts to government regulatory agencies. Self-regulatory organisations support the Federal Securities Market Commission in its efforts to regulate the security markets. Self-regulatory organisations are private, non-profit corporations, their operations financed by membership fees and, to some extent, grants and income from certain activities.

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31 Securities Market Law, art 3, part 9.

32 Presidential Decree on Measures of Formation of the All-Russia Telecommunication System and Provision for Rights of Owners of Securities Storage and Payments at the Securities Exchange of the Russian Federation of 3 July 1995, Number 662 (as amended); Presidential Decree on Additional Measures for Formation of the All-Russia Telecommunication System for Participants in Financial and Stock Markets of the Russian Federation of 4 January 1996 Number 6; Government Decision on Measures for Creation of a National Depository System of 10 July 1998 (as amended); Government Decision on the Procedure for Providing Documents Confirming Rights to Securities Deposited in or Rights Recorded in the National Depository System by the Central Depository — Central Fund for Depositing and Considering Information on the Stock Market of 16 March 1999, Number 291.

33 See http://www.auver.ru.

To receive the status of a self-regulatory organisation, an entity must be certified as such by the Federal Securities Market Commission. Only three organisations have been licensed as self-regulatory organisations, namely:

- PARTAD;
- NAUFOR; and
- NSMA.

Membership is voluntary. NAUFOR includes approximately 1,000 participants, PARTAD and NSMA approximately 200 each. Membership in self-regulatory organisations does not eliminate the requirement of licensing, and it does not relieve securities professionals from scrutiny by the Federal Securities Market Commission and other regulatory authorities.

Clearing Agents and Depositories. Clearing activity is understood as the activity on determination of mutual obligations (eg, collection, checks, correction of information on securities transactions, and preparation of documents for them) and clearance of securities delivery and payments for them.[34] Only juridical persons can deal with clearing in Russia.[35]

Taking into account that clearing organisation perform operations on setting off of mutual claims for securities transfer and payment, part 3 of article 6 of the Securities Market Law requires a clearing organisation to set aside special (reserve) funds for payments under securities transactions. These funds serve to decrease the risk of non-execution of securities transactions. The minimal volume of reserve funds of clearing organisations is established by the Federal Securities Market Commission in agreement with the Central Bank of Russia.

Depository activity includes rendering services relating to custody of securities certificates and/or recording the transfer of title to securities. A professional participant in the securities market performing such functions is called a depository. Only a juridical person can be a depository.[36] The relations between a depository and a client (depositor) are governed by a depository contract (contract of a depo account). A depository contract must be concluded in writing and contain the following material terms:

- Unambiguous determination of a subject of the contract, encompassing provision of services for the custody of securities certificates and/or accounting of rights to securities;
- Procedure for providing information about transfer of the depositor's securities to a depository;

34 Securities Market Law, art 6.
35 Securities Market Law, art 6, part 3.
36 Securities Market Law, art 7, parts 1 and 2; Federal Securities Market Commission Decree Number 36 of 16 October 1997 on Approval of the Order on Depositary Activity in the Russian Federation, Establishment of the Procedure for Its Implementation, and the Sphere of Application.

- Duration of contract;
- Depository fees and the procedure for payment;
- Periods for reporting by a depository; and
- Depository obligations.[37]

A depository has no right to dispose of the depositor's securities, manage them, or perform any actions with securities on behalf of a depositor, except where it performs a depositor's instructions in the cases provided for in the depository contract.

Brokers and Dealers. 'Brokerage' is defined by the Securities Market Law as execution of civil law transactions with securities as an attorney or an agent, acting on the basis of a commission agency contract, a contract of delegation, or power of attorney to perform such transactions with no indications as to a power of attorney or agent in an agreement.[38] A broker may be a natural person or organisation. A professional participant in the securities market which is engaged in brokerage is called a broker.

The Securities Market Law provides special regulations applicable to the commission or agency performed by a broker compared to general regulations foreseen in the Civil Code. When a broker acts as a commission agent, the contract of a commission may provide for the obligation to record client funds destined for investment into securities or recovered from securities sales on the broker's off-balance accounts and the right of the broker to use them until such time as when they are returned to a client under the contract conditions. A part of the profit realised from use of the above, the balances of a client's funds must be paid to the client in accordance with the contract. However, a broker cannot guarantee or promise to a client future profits from investment of funds.

'Dealing' is defined by the Securities Market Law as the execution of buying and selling transactions on behalf of oneself and at one's own expense by offering public buy or sell quotes of certain securities with an obligation to buy or sell the securities at a declared price.[39] A professional participant in the securities market who performs dealing is called a dealer. A dealer, in contrast to a broker, can be only a juridical person established as a commercial organisation. Individual businessmen have no right to act as dealers.

A dealer has no right to escape entering the transaction on terms publicly declared by him. Therefore, such public declaration is none other than a public offer.[40] However, the Securities Market Law establishes not only the peculiarity of the dealer offer, but also acceptance. First, for an offer to be considered as declared, it must quote a price. Second, if a dealer did not stipulate in the sale or purchase offer such conditions as the number of securities, as well as the period of validity, he is obliged to accept a tender on terms offered by a client.[41]

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37 General conditions of depository services approved by a depositor must be attached to the contract and form its integral part; Securities Market Law, art 7, part 4.
38 Securities Market Law, art 3.
39 Securities Market Law, art 4.
40 Civil Code, art 437.
41 Securities Market Law, art 4, part 3.

Underwriters. The Federal Securities Market Commission normative acts regulating dealing use the term 'underwriting'.[42] 'Underwriter' is defined as a person undertaking to place securities on behalf of an issuer or in its own name, but at the expense of an issuer after its commission.[43]

Other Market Participants. The Securities Market Law does not limit the possibility to create organisations which professionally, ie, deliberately and on a permanent basis, carry out other types of operations in the securities market. However, such organisations are not considered to be professional participants in the securities market.

This group is represented by non-profit organisations set up for protection of rights of investors and shareholders.[44] These organisations include:

- The Federal Public-State Foundation on Safeguarding the Rights of Depositors and Shareholders;[45]
- Regional and local foundations for safeguarding the rights of depositors and shareholders;[46] and
- The Federal Compensation Fund.

Capital of such foundations is formed by promoters' contributions, voluntary payments of organisations and citizens, earnings from use of foundation funds, and income from business and other activity performed by foundations. Assets of the foundations are used for compensation payments to depositors and shareholders. They may be invested in securities and other liquid assets, provided that the earnings are directed into compensation payments.

Securities

National Treatment and Reciprocity. The Federal Law on Foreign Investments[47] provides for a limited national treatment of foreign investments. Analogous provisions are found in bilateral investment treaties of the Russian Federation. These provisions are applicable to portfolio investments as well as other investments.

Restrictions relating to acquisition and holding of shares of businesses in certain industries by foreigners may be introduced by federal laws where it is necessary to protect the

42 Federal Securities Market Commission Decree of 19 December, 1996 (as amended).
43 Standards of Issue of Option Certificates and Their Issue Notes, item 2, approved by Federal Securities Market Commission Decree Number 1 of 9 January 1997 (as amended); Standards of Issue of Stock, Shares, Additional Shares, Bonds, and Their Issue, Notes at Promotion of Joint-Stock Companies, approved by Federal Securities Market Commission Decree of the Russian Federation Number 19 of 17 September 1996.
44 Government Decision Number 785 of 17 July 1998.
45 Decree of the President of the Russian Federation of 18 November 1995, Number 1157 (as amended).
46 Decree of the President of the Russian Federation of 11 September 1997, Number 1009.
47 Federal Law on Foreign Investments in the Russian Federation of 9 July 1999, Number 160-FZ.

fundamentals of the constitutional system and public moral, health, rights, and lawful interests of other persons and to safeguard the defence and national security of the state.

Listed Securities. 'Listed securities' are understood in Russia as securities traded through 'an organiser of trade in the securities market'. To be admitted to the floor for trading on the stock exchange, the securities must pass the procedure of listing and be included in the special quotation list.[48] Unlisted securities may be traded if they are admitted by the internal regulations of the stock exchange. Rules of trading adopted by an organiser of trade may provide for certain requirements for an issuer of unlisted securities.

Quotation lists must include two classes (types of admission), ie, class 'A' (the 'first' and 'second' sub-classes) and class 'B'. For securities to be eligible for listing on the quotation list as A or B class securities, issuers must satisfy certain standards.[49]

Issuer Requirements

Investment securities may be issued only by legal entities (private issuers) or by government or local self-governmental bodies (public issuers). An issuer is an entity which assumes obligations to the owners of securities (investors), ie, the persons who may exercise the rights certified by securities. Private issuers are normally commercial legal entities. It is specified in Federal Law Number 46-FZ of 5 March 1999 that issue of investment securities by non-commercial organisations is permitted only in cases specifically authorised by legislation and is subject to provision of collateral. To qualify as an issuer, a person must meet the requirements established in the normative acts of the Federal Securities Market Commission and the Central Bank of Russia.

Only legal entities incorporated as joint-stock companies may issue shares of stock. Open joint-stock companies may carry out both private and public offerings. Closed joint-stock companies are only eligible for private offerings. Bonds may be offered to the public by joint-stock companies of any types, as well as by limited-liability companies. Bonds may be issued by any issuer only after its charter capital is paid in.[50]

The paid-in capital of an open joint-stock company (representing the required initial investment by incorporators before the company may go public) may not be less than 1,000 Minimum Statutory Wages (MSW), as stipulated by the federal law at the date of registration of a company.[51] For most corporations, however, a right to carry out public offerings is contingent on the condition that their paid charter capital at the date of the issue is not less than 10,000 MSW.[52] This restriction does not apply to open joint-stock

48 Securities Market Law, art 14.
49 Regulation on Requirements for Organisers of Trade in the Securities Market, item 5, approved by Decree of the Federal Securities Market Commission of 4 January 2002, Number I-ps.
50 Presidential Decree Number 1233 of 11 June 1994 on Protection of Investor Interests, art 5.
51 Law on Joint-Stock Companies, art 26.
52 Russian Federation President's Decree of 11 June 1994, Number 1233, item 3 (as amended).

companies created in the process of privatisation of state and municipal enterprises. Acquisition of the shares publicly offered in violation of the above requirements may be considered invalid (void) under article 168 of the Civil Code.

Securities Requirements

In General. Investment securities can be issued in one of the following forms:

- Registered securities of documentary form of issue (registered documentary securities);
- Registered securities of non-documentary form of issue (registered non- documentary securities); or
- Bearer securities of documentary form of issue (bearer documentary securities).

When taking a decision to issue securities in the documentary form, an issuer may determine that securities certificates may be released to holders (securities without mandatory centralised keeping) or be kept in depositories and not be given at hand to any holder (securities with compulsory centralised keeping). Most public issues of investment securities are accompanied by a single global certificate, and trades or change of ownership occurs through a depositary.

Investment securities to the bearer can be issued only in documentary form. Registered investment securities may be issued in documentary or non-documentary form. Investment securities with the same state registration number must be issued in the same form.

Shares of Stock. Shares of stock are investment securities certifying the rights of the owner (shareholder) to receive a part of a profit of a joint-stock company as a dividend, to participate in management of a joint-stock company, and to collect a share of assets remaining after liquidation of the company and settlements with creditors.[53] The list of rights certified by shares of stock is not closed. Article 96 of the Civil Code provides that the rights and obligations of shareholders must be defined by the Joint-Stock Company Law. Additional shareholder rights also may be granted in the charter of the company pursuant to article 67 of the Civil Code and article 32 of the Joint-Stock Company Law.

All shares of Russian companies are registered shares.[54] This a great impediment to free trade in securities. The Securities Market Law provides for the possibility of issue of bearer shares by joint-stock companies 'in a certain ratio to the amount of paid nominal capital of an issuer in accordance with the regulation established by the Federal Securities Market Commission'.[55] These normatives have not been passed and, therefore, bearer shares are not issued by Russian joint-stock companies.

Russian law recognises the traditional classification of shares as common and preferred. Holders of common shares have ordinary rights. These rights are enumerated in article 31

53 Securities Market Law, art 2.
54 Joint-Stock Company Law, art 25.
55 Securities Market Law, art 21.

of the Joint-Stock Company Law. Among them is the right to participate in a meeting of shareholders with voting power on issues of its competence, the right to receive dividends, and the right to a share of the company's assets in the case of liquidation. By virtue of article 31(1) of the Joint- Stock Company Law, all holders of common shares of all issues have the same rights. Therefore, the nominal value of equity shares is the same regardless of the sequence of issue.[56]

Preferred shares grant some preferences to shareholders in terms of dividend and asset distribution as compared to common shares. As a general rule, preferred shares cannot vote.[57] Exceptions to this rule are provided for in article 32(4) and (5) of the Joint-Stock Company Law. Different issues of preferred shares may confer different rights on the shareholder. The Joint-Stock Company Law offers several examples of such differentiation. Thus, a holder of a preferred share can have the priority to receive so-called liquidation value[58] or the priority right to distribution of dividends.[59]

The preferred shares of the same type give to shareholders the same rights and have the same nominal value. Nominal values of preferred shares of different types can differ from each other and from the nominal value of common shares. The nominal value of all placed preferred shares of all types cannot exceed 25 per cent of the total amount of the charter capital.

Not every joint-stock company is entitled to issue common and preferred shares or registered and bearer shares. So-called 'popular enterprises' may have only common shares in circulation.[60] The same restriction applies to investment funds which are set up in the form of open joint-stock companies. They may issue only common registered shares.[61]

One of the most prominent examples of peculiar rights of a holder of shares of a joint-stock company formed as a result of privatisation was the 'golden share',[62] which gave its holder (the state) veto power in respect of most significant decisions by a general shareholders' meeting. The Privatisation Law approved in 1997 provided that joint-stock companies formed as a result of privatisation issue essentially the same categories of shares as other joint-stock companies. The Law effectively transformed what used to be a 'golden share' into special rights of the state to take part in the management of the privatised company. The concept of 'golden share' remains in the new Privatisation Law of 21 December 2001.

When classifying shares, one should keep in mind that the Joint-Stock Company Law operates with the categories of authorised and issued shares.[63] Russian law defines shares

56 Joint-Stock Company Law, art 25(1).
57 Joint-Stock Company Law, art 32(1).
58 Joint-Stock Company Law, arts 23(1) and 32.
59 Joint-Stock Company Law, arts 23 and 32.
60 Federal Law Number 115-FZ of 20 July 1998 on Peculiarities of Legal Status of Employees' Joint-Stock Companies (Popular Enterprises), art 4.
61 Federal Law Number 156-FZ of 29 November 2001 on Investment Funds, art 4.
62 Decree of the President of the Russian Federation Number 1392 of 16 November 1992 on Measures for Realisation of Industrial Policy at Privatisation of State Enterprises, item 4.
63 Joint-Stock Company Law, art 27.

which are purchased (even if the full payment of the purchase price was not received by the issuer) as issued or placed. Authorised are shares which can be, from time to time, placed with shareholders or third persons according to a decision of a general shareholders' meeting or the board of directors. The notion of authorised shares actually refers not to the securities, but to the provision in the charter of the company allowing issue of securities within certain limits. Authorised shares do not exist as such, being in essence the nominal category. The purpose of this category is to outline the amount and other conditions of shares that may be further issued by a joint-stock company.

Finally, the Joint-Stock Company Law refers to 'additional shares'. These are newly issued shares of a joint-stock company that are offered, but not acquired by an investor. This distinguishes them from placed shares, ie, shares which already have a specific owner.

Bonds (Debentures). Bonds are a type of investment securities certifying the right of their holder to receive nominal value of a bond or other equivalent assets from a person who has issued a bond, at a certain time. A bond entitles its holder to interest indicated therein and sometimes for other proprietary rights.[64] A similar definition of a bond is given in article 2 of the Securities Market Law. Issue of bonds by any issuer is allowed only after its charter capital is paid in full.[65]

Bonds are essentially a form of the loan agreement. The use of this form is restricted. The issue of bonds as a means of borrowing may be used only in cases specifically authorised by law. Bonds may be issued for loans by joint-stock companies, limited-liability companies, the Central Bank of the Russian Federation, and certain other organisations.

Offering of bonds by a company requires a decision of the board of directors, unless otherwise provided for by the charter of a joint-stock company.[66] A bond must have a declared nominal value. The nominal value of all bonds issued by a company may not exceed the company's own charter capital or the value of security provided by a third party for the issue of bonds.

A company has the right to issue bonds secured by company assets or a security provided by a third party. Issue of unsecured bonds is allowed only three years after incorporation and under condition of proper certification of financial reports. Both registered and bearer bonds may be issued. A company which issues registered bonds must keep a register of holders. Issue of bonds is barred for joint-stock companies engaged in certain types of activity.[67]

Limited-liability companies may issue bonds subject to the requirements of the Limited-Liability Company Law, article 31. Regulations applicable in this case are essentially the same as those applicable to bonds issued by a joint-stock company. However, some differences exist. A limited-liability company issuing bonds is obliged to publish its financial

64 Civil Code, art 816.
65 Presidential Decree Number 1233 of 11 June 1994 (as amended), art 5.
66 Law on Joint-Stock Companies, art 33.
67 Federal Law Number 156-FZ, 29 November 2001, on Investment Funds, art 4.

reports, a requirement which does not apply to other companies in this form. A company has a right to place bonds for a sum not exceeding the amount of its nominal capital or the amount of security given to a company by a third party. In all other aspects, for which the Limited-Liability Company Law offers no guidance, such companies should follow the special laws on securities and, in particular, the Securities Market Law.

Federal Law Number 139-FZ of 8 July 1999 has authorised that bonds may be issued by the Bank of Russia, in its name, for the purpose of implementation of its monetary policy. Bonds of the Central Bank may be traded only between financial institutions. The procedure of issue is approved by the Government of the Russian Federation Decision Number 1142 of 12 October 1999, as amended. However, the regulation is effective only until 1 January 2003.

State and Municipal Securities. Trading of state investment securities is the largest sector of the securities market in Russia in terms of volume. State investment securities include the following instruments:

- State short-term coupon-less bonds;[68]
- State treasury bonds;[69]
- State bonds of internal currency loans;[70]
- State bonds of external loans;[71]
- State bonds of savings loans;[72]
- State saving bonds;[73]
- Gold certificates of the Ministry of Finance of the Russian Federation;
- Bonds of federal loans with variable and permanent coupon yield;[74]
- State federal bonds;[75]
- State gold bonds;[76]
- State commodity bonds;[77]
- Treasury bills of exchange;[78] and
- State bonds of non-market loans.[79]

68 Government Decision Number 790 of 16 October 2000.
69 Government Decision Number 906 of 9 August 1994.
70 Government Decision Number 222 of 15 March 1993; Government Decision Number 229 of 4 March 1996.
71 Government Decision Number 302 of 14 March 1998.
72 Government Decision Number 379 of 16 May 2001.
73 Government Decision Number 771 of 6 November 2001.
74 Government Decision Number 458 of 15 May 1995.
75 Government Decision Number 439 of 12 May 1998.
76 Government Decision Number 861 of 27 July 1998. These bonds are expected to maintain circulation of precious metals; Federal Law Number 41-FZ of 26 March 1998 (as amended), art 22.
77 Law of the Russian Federation of 1 June 1995 on State Loan Commodity Obligations.
78 Government Decision Number 321 of 14 April 1994.
79 Government Decision Number 316 of 21 March 1996.

General provisions on state loan contracts are found in article 817 of the Civil Code, which provides that a state loan contract is concluded when a creditor purchases state bonds or other state securities. The state securities certify the creditor's right to receive from a debtor (the state) the money or, depending on the loan conditions, other assets, interest, or proprietary rights on the terms provided for in the conditions of the loan.

In a state loan contract, the public entity (the Russian Federation or a sub-unit of the Russian Federation) is a debtor. Both legal persons and individuals may be creditors. Certain restrictions apply to participation of foreign investors. State loans are voluntary, and unilateral modification of their terms is not allowed. Regulations governing state loan contracts are equally applicable to borrowing by municipalities. The state may offer bonds both domestically and internationally. Altogether, these borrowings constitute the bulk of internal and external debt of the Russian Federation. The legal nature of state securities as a specific borrowing by the state is expressly recognised in article 98 of the Budget Code.[80]

State and municipal securities can be issued in the form of bonds or other securities qualifying as investment securities. These securities may entitle the holder to claim money or, depending on issue conditions of these securities, other assets, declared interest, or other proprietary rights.

Secondary Securities Requirements. Derivative (secondary) securities are mentioned in article 19 of the Securities Market Law. Derivative securities certify the right of their holder to sell or buy other securities of issue and circulation of securities and stock exchanges in Russia approved by the Decision of the Government of the Russian Federation Number 78 of 28 December 1991. Issue of derivative securities is prohibited until the report on issue of underlying (primary) investment securities has been registered.

The Federal Securities Market Commission recognises option certificates as derivative securities. An option certificate in Russia is defined as a registered investment security certifying the right of its holder to buy (call option) or to sell (put option) shares or bonds under certain conditions.[81] An option certificate may only be issued in respect of a joint-stock company that complies with certain requirements stipulated by the Federal Securities Market Commission. In particular, the issuer of the mentioned shares must have access to the quotation of securities, at least at one stock exchange or trade system of an organiser of trade; the issuer may not have taken decisions on reorganisation, consolidation, or split of the shares, on increase of their nominal value, on payment of dividends on the shares, 'as well as other corporate events at the moment of taking a decision on issue of option certificates'.[82]

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80 Federal Law Number 145-FZ of 31 July 1998, as amended.

81 Regulation of the Federal Securities Market Commission Number 1 of 9 January 1997 on Option Certificates, Their Application, and Approval of the Issue Standards of Option Certificates and Their Issue Notes.

82 Decree of the Federal Securities Market Commission of 9 January 1997, Number 1, item 2.

Prospectus Requirements. Registration and disclosure of the issue prospectus is mandatory in case of public offerings (an offering of securities to the unlimited range of owners or holders) in all cases and private offerings (among investors, known in advance) but only if the number of investors exceeds 500 and, regardless of the number of the potential holders, in cases where the total volume of issue exceeds 50,000 minimum statutory wages. The issue prospectus must contain the following:

- Data on the issuer;
- Data on the financial position of the issuer; and
- Information about the securities issue.

The data on the issuer must include:

- The full and abbreviated name of the issuer or the names of the founders;
- The legal address of the issuer;
- The number and data of the certificate of state registration as a legal entity;
- Information about the persons possessing not less than five per cent of the issuer's authorised capital;
- The structure of the issuer's governing bodies, indicated in its constituent documents, including the list of all the members of the council of directors, the board, or the administrative bodies of the issuer who perform similar functions at the time of the adoption of a decision on the securities issue with an indication of the surname, name, and patronymic of each member and all the posts held by each at the present time and during the last five years, and the decision on the issue of shares in the issuer's authorised capital belonging to those members who are personally its participants;
- The list of all legal entities in which the issuer possesses more than five per cent of the authorised capital; and
- The list of all the branches and representative offices of the issuer containing their full names, date and place of registration, and the legal addresses, surnames, names, and patronymics of their managers.

Information on the issuer's financial position must include:

- The balance sheets;
- The report on the formation and use of the reserve fund resources during the last three years;
- The amount of the overdue indebtedness of the issue to creditors and in payments to the corresponding budget on the date of the adoption of a decision on the securities issue;
- Data on the authorised capital of the issuer; and
- The report on the previous issues of securities of the issuer, including the types of the issued securities, the number and data of state registration, the name of the registration body, the size of the issue, the number of issued securities, and the conditions of payment of incomes, and other rights of owners.

Corporate Governance. Most private issuers have a three-level management structure. A joint-stock company's business is conducted by the following governing bodies:

- The general shareholders' or members' meeting;
- The board of directors or supervisory council;
- The managing bodies: and
- The collegial or individual executive body.

Registration of Public Offerings. Public offerings and private offerings of investment securities are subject to registration with the state. At the time of such registration, each issue is assigned a For the state registration of a securities issue, an issuer must present to the registration body an application and certain other documents:

- An application for registration;
- A decision on the securities issue;
- An issue prospectus (if the registration of the securities issue must be accompanied by the registration of the issue prospectus);
- Copies of by-laws (in the case of the issue of shares for the setting up of a joint-stock company); and
- Documents certifying the authorisation of the competent public government body (in cases where such authorisation is required under the legislation of the Russian Federation).

The issue procedure also must correspond to the Issue Standards approved by the Federal Securities Market Commission.[83]

An exhaustive list of the grounds for denying the registration of securities issues is provided in article 21 of the Securities Market Law. It includes:

- Violation of the securities legislation by the issuer, including ambiguity of the submitted documents which makes it impossible to make a conclusion on the compliance of the terms of the issue and circulation of securities with the legislation of the Russian Federation and the disparity between the terms of the securities issue and the legislation on securities; and
- Submission of false information in the issue prospectus, the decision on the securities issue, and/or other documents which are the grounds for registration of the securities issue.

83 Standards of Issue of Stock at Incorporation of Joint-Stock Companies, Additional Stock, Bonds, and Issue Prospectuses, approved by Federal Securities Market Commission Regulation Number 19 of 17 September 1996 (as amended); Instruction of the Central Bank of Russia Number 8 of 17 September 1996 (as amended) on Rules of Issue and Registration of Securities by Credit Organisations at the Territory of the Russian Federation; Standards of Issue of Shares and Bonds and Their Issue Notes at Reorganisation of Commercial Organisations, approved by the Federal Securities Market Commission Decree of 12 February 1997, Number 8; Federal Securities Market Commission (part 2, item 1 of the Standards).

A decision on the refusal to register the securities issue and the issue prospectus may be appealed to a court. If the offering is declared invalid, all securities of the issue must be returned to the issuer, and an issuer must refund proceeds from the offering to securities holders. In such a case, securities holders have an option to recover, in addition to the principal amount paid for shares, interest[84] and damages.[85] Claims for declaring a placement invalid are subject to a shortened limitation period. They must be filed within one year after the commencement date of the offering.[86]

Registration of Placements. The issuer must submit its report on the results of the securities issue to the registration body within 30 days after completion of placement of issued securities. The report must contain:

- The dates of opening and closing of placement;
- The price of placement of securities;
- The number of placed securities; and
- The total amount of raised funds, including the amount of national currency (roubles) paid for securities, the amount of foreign currency paid for securities with the equivalent in the currency of the Russian Federation at the rate of the Central Bank of Russia at the time of contribution, and the value of tangible and intangible assets, contributed as payment for the securities expressed in the currency of the Russian Federation.

Where an issue of securities is not registered, such securities may not be traded on the secondary market. As a general rule, the transfer of title to the security to the first owner does not depend on the full payment for the security. However, further transfers of title are prohibited, until the security is paid in full and the report on results of issue is registered with the state.[87]

Registration of Secondary Trades. A transaction with shares is not deemed closed until the transfer of title is registered with the registrar. To facilitate development of the securities market, the institution of specialised depositories (custodians) was introduced, and the transaction may be closed on the depository books.

Registration of Trade in Organised Market. An organiser of the trading must maintain the register of all transactions closed at the trading sessions, including the following information:

- The transaction identification number;
- The date and time the trade was registered in the trading system;

84 Civil Code, art 395.
85 Civil Code, art 835; Regulation on the Procedure for Reimbursement to the Securities Holders of Money (Other Property) Received by the Issuer against Payment for the Securities which Issue was Recognised Null or Void, approved by Order of the Federal Securities Commission Number 36 of 8 September 1998.
86 Law on Protection of Investors' Rights, art 13.
87 Law on Protection of Investors' Rights, art 5, item 2.

- The names and individual codes of participants of the trade who effected the trade;
- The name of the issuer, type (category) of the security, or name of the other financial instrument;
- The par value of a security;
- The cash value of the transaction; and
- The quantity of securities or financial instruments.

Periodic Disclosure

Public Issuers

In General. An issuer and securities market professionals participating in placement of investment securities must provide potential investors an opportunity to access disclosed information prior to the acquisition of investment securities. Issuers which were required to register an issue prospectus for at least one issue of investment securities are obliged to disclose information about all investment securities issued by them, and their financial and economic activity in the following forms:

- Quarterly reports of an issuer;[88]
- Statements on essential facts affecting the financial and economic activity of an issuer.[89]

According to the Securities Market Law, the contents and procedure of the reporting forms differ for issuers who have already completed the placement of shares and issuers who have ongoing public placements as of the reporting date. However, the Federal Securities Market Commission claims that the second, more extensive set of requirements must apply to all issuers, including those which have already completed the placement. The Federal Securities Market Commission has approved an extended, unified, and mandatory form for the quarterly report.[90]

Quarterly Reports. According to the Securities Market Law, the quarterly report of the issuer which has completed the placement must contain the following:

- The registration codes assigned by the registration body to statements about the essential facts of the issuer's financial and economic activity, filed during the reporting quarter;
- Data on the issuer's financial and economic activity, the balance sheet, and the profit-and-loss accounts at the end of the reporting quarter;

88 Regulations on the Quarterly Report of the Issuer of Securities, approved by Decision of the Federal Securities Market Commission Number 31 of 11 August 1998.

89 Regulations on the Procedure for Disclosure of Information on Essential Facts Affecting the Issuer's Financial and Economic Activity, approved by Federal Securities Market Commission Decision Number 32 of 12 August 1998; Regulation of the Central Bank of Russia Number 43-P of 2 July 1998.

90 Federal Securities Market Commission Decision Number 31 of 11 August 1998.

- Information on facts relating to increase in the issuer's net profits or losses by more than 20 per cent during the reporting quarter (as compared with the previous quarter); and
- Data on the formation and use of reserves and other special funds.

Statements of Essential Facts. According to the Securities Market Law, the list of situations requiring periodic disclosure in the form of the statement on essential facts affecting the issuer's financial and economic activities also differs for issuers who have already completed the placement of shares and for issuers who are still in a process of public placement. Both groups of issuers must file statements in the following situations:

- Reorganisation of the issuer and its subsidiary and dependent companies;
- Distributions on issuer's securities which are declared or paid; and
- Registration of a person who owns more than 25 per cent of issued securities of any particular type.

For issuers which do not have a securities placement in progress, the statement must be filed if the following take place:

- Changes in the list of the issuer's officers (persons who serve in the issuer's management bodies other than the general participants' or shareholders' meeting);
- Changes in the ownership of the issuer and in its subsidiary and dependent companies by the issuer's officers;
- Changes in ownership of the issuer's officers in capital of other legal entities where they hold a stake of 20 per cent or more;
- Changes in the list of owners (shareholders) having a share of 20 per cent of the issuer's authorised capital or more;
- Changes in the list of legal entities which are 20 per cent or more owned by an issuer;[91] and
- The securities are cancelled, suspended, or recognised as void.

The Federal Securities Market Commission has approved an extended, unified list of situations requiring statements of essential facts for issuers who have completed a placement and issuers who have an ongoing public placement.[92] Statements must be submitted to the Federal Securities Market Commission, or the body authorised by it, and be published in the Appendix to the Bulletin of the Federal Securities Market Commission and another publication accessible to most owners of the issuer's securities within five working days after the relevant development takes place.[93]

91 Procedure for Publication of Information on Acquisition by a Joint-Stock Company of More Than 20 Per Cent of Voting Shares Issued by Another Joint-Stock Company, approved by Decision of the Federal Securities Market Commission Number 10 of 14 May 1996.
92 Federal Securities Market Commission Decision Number 32 of 12 August 1998.
93 Federal Securities Market Commission Decision Number 32 of 12 August 1998.

Disclosure by Joint-Stock Companies. In addition to the above requirements, open joint-stock companies must disclose[94] the following:

- The annual report of the company, balance sheet, and other annual accounting;[95]
- An issue prospectus for shares of stock in cases provided for by the normative acts;
- Notices of convening of the general meeting of shareholders according to the procedure provided for by the Law on Joint-Stock Companies;[96] and
- Other information specified by the Federal Securities Market Commission.[97]

The Federal Securities Market Commission, by Decision Number 9 of 8 May 1996, has supplemented the list of information subject to mandatory disclosure with the following data to be published in the mass media:

- Correlation of the value of net assets and the size of authorised capital;
- Number of shareholders;
- Details concerning registrars maintaining the register of securities owners (name, corporate form, location, mailing address, contact telephone numbers, number of a licence issued by the Federal Securities Market Commission (if the register is kept by a specialised registrar); and
- Details concerning the department of the joint-stock company in charge of keeping the register of securities owners of the shareholders: its location, mailing address, and contact telephone numbers (if the joint-stock company keeps the register itself).

Disclosure by Joint-Stock Companies Issuing Bonds. Both public (opened) and private (closed) joint-stock companies, in the event of the public issue of bonds or other investment securities, must publish information on the scope and procedure established by the Federal Securities Market Commission.[98]

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94 Law on Joint-Stock Companies, art 92.

95 Procedure for Publication of Annual Accounting Reporting by Open Joint-Stock Companies, approved by Order of the Ministry of Finance of the Russian Federation Number 101 of 28 November 1996; Peculiarities of the Publication of the Annual Accounting Reporting by Insurance Organisations, approved by Order of the Ministry of Finance of the Russian Federation Number 17 of 21 February 1997. Public joint-stock companies, as well as banks and other credit organisations, insurance companies, investment funds, and some other organisations regardless of legal form, must publish annual reports not later than 1 June of the next year; Federal law of 21 November 1996 Number 129-FZ, art 16.

96 Federal Securities Market Commission Decision Number 8 of 20 April 1998.

97 Federal Securities Market Commission Decision Number 7 of 30 September 1999 on Procedure for Recording Affiliated Persons and Providing Information on Affiliated Persons of Joint-Stock Companies. The definition of 'affiliated persons' is provided in antitrust legislation of the Russian Federation; Federal Securities Market Commission Decision Number 9 of 8 May 1996 on Additional Data Which an Open Joint-Stock Company Must Publish in the Mass Media.

98 Decision of the Federal Securities Market Commission Number 8 of 7 May 1996; Decision of the Federal Securities Market Commission Number 9 of 20 April 1998.

Disclosure by Limited-Liability Companies. Limited-liability companies, in contrast to joint-stock companies, are generally not obliged to publish information on their activity.[99]

This rule is reversed, however, for limited-liability companies which carry out public placement of bonds and other securities. In such a case, the company must publish annual reports and balance sheets, as well as other data on its activity.

Disclosure by Issuers of State and Municipal Securities. Disclosure of information on the issue of state and municipal securities includes publication of the normative act under which the securities were issued, reports on performance of the relevant state or municipal budgets of each quarter, and certain other data.[100]

Securities Owners (Investors)

The Securities Market Law provides for disclosure of operations with securities by holders (investors) when:

- The holder has taken possession of 20 per cent or more of the issuer's securities of any type;
- The holder has increased his share of possession of any type of issued securities of one issuer beyond the threshold levels amounting to multiples of each five per cent above 20 per cent of this type of securities (eg, 25 per cent, 30 per cent, or 35 per cent); and
- The holder has reduced his share of possession of any type of issued securities of one issuer below a threshold set at each multiple of five per cent of the overall number of securities of the type in excess of 20 per cent of this type of securities (eg, 25 per cent, 30 per cent, or 35 per cent).

The holder must send to the Federal Securities Market Commission, or another body appointed by it, a notice disclosing the name of the holder, type and registration number of securities, the name of the issuer, and the quantity of securities in his possession within five days after the corresponding transactions. A commercial organisation which has acquired more than 20 per cent of the voting shares of the joint-stock company must publish this information without delay.[101]

Affiliated persons must comply with special disclosure obligations. They must inform an issuer about their ownership of its stock, specifying quantity and categories (or types) of shares of stock owned by them within 10 days from the date of acquisition of the stock.[102] This rule corresponds to the obligation of an issuer to disclose information on affiliated persons described above. An affiliated person who has failed to provide a notice must reimburse an issuer for resulting damages.

99 Federal Law on Limited-Liability Companies, art 49.
100 Federal Law Number 136-FZ of 29 July 1998, art 12.
101 Civil Code, art 106; Law on Joint-Stock Companies, art 6.
102 Law on Joint-Stock Companies, art 93.

Securities Market Professionals

Securities market professionals are obliged to disclose information about their operations with securities when:

- A securities market professional was involved in operations with one type of securities of one issuer during one calendar quarter, provided that the aggregate number of securities involved in the operations exceeded 100 per cent of the total number of the securities; and
- A securities market professional was involved in a single operation with one type of securities of one issuer if the number of securities in this operation constituted not less than 15 per cent of the total number of the securities.

Securities market professionals must disclose operations by sending to the Federal Securities Market Commission, or another body appointed by it, a notice specifying the name of the securities market professional, type and registration code of securities, the name of an issuer, the price of one security, and the number of securities in relevant transactions within five days after the completion of the relevant quarter or after closing of the relevant single operation.

When securities market professionals offer securities and/or announce buy or sale prices, they must disclose the generally accessible information in their possession (ie, the information which is disclosed by the issuer of these securities) or at least explain that such information is available. Article 6 of the Federal Law on Investors' rights imposes further disclosure obligations on the securities market professionals. They are obliged to inform potential investors about prices of transactions with relevant securities during the six preceding weeks or at least indicate that such information is available and will be provided on request.

Other Disclosure Obligations

Issuers of certain securities have passive disclosure obligations, ie, a duty to provide information on request. Such issuers are obliged to collect and store the relevant information and make it available to investors and other participants in the market. For example, a joint-stock company must provide access to some internal documents of the company (excluding bookkeeping records and minutes of meetings of a collegial executive body) to its shareholders. On request of a shareholder, a company must furnish copies of these documents for a fee, which may not exceed the copying and postal costs.

In addition, shareholders must be notified on various corporate events, such as the calling of the general shareholders' meeting, its agenda, information to be considered at the meeting, and their right to demand redemption of shares by the company.

Foreign Issuers with Primary and Secondary Admission

Neither primary nor secondary securities of foreign issuers are admitted to trade in Russia.

Issuers without Ongoing Disclosure Duties

An issuer does not have ongoing disclosure duties in the forms of quarterly reports of an issuer and statements of essential facts if, for no one issue of securities by the issuer, an issue prospectus was required. Issuers still have certain obligations regarding disclosure of information.

Issuers and securities market participants facilitating an offering must provide potential investors an opportunity to examine the information subject to disclosure before acquisition of corresponding investment securities. Acquisition by residents of shares issued by foreign issuers also must be reported the Federal Securities Market Commission by the parties.

Privileged 'Foreign Private' Issuers

Acquisition by residents of the shares issued by foreign issuers also must be reported the Federal Securities Market Commission by the parties.

Proxy Disclosure

There are no rules in Russia requiring proxy disclosure.

Trading Rules

Securities Offerings

Offer. Legislation provides certain procedures for the issuer to comply with to complete the issue. The procedure of securities issue itself is defined as a sequence of actions of an issuer with the purpose of placement of investment securities.

The securities issue should be accompanied by the registration of the securities issue prospectus if the investment securities are placed among an unlimited group of investors (public placement) or among a closed group of investors known in advance (private placement), but the number of subscribers exceeds 500 or the aggregate amount of issue exceeds 50,000 minimum statutory wages.

Public Offerings. A public offer of the stock of shares is only available to open joint-stock companies. A public offer of the investment securities by private issuers requires registration of the issue prospectus. Otherwise, the procedure of the public offer is essentially the same standard procedure.

Place of Offer. The domicile of an issuer is deemed to be the place of offer.

Licensing of Transactions with Securities. For circulation of shares through professional participants in the securities market, legislation requires a licence.[103]

103 Securities Market Law, art 9; Decree of the Federal Securities Market Commission Number 22 of 19 December 1996; Decree of the Federal Securities Market Commission Number 16 of 9 September 1996.

Absence of such a licence in certain conditions can serve as a basis for the invalidity of the corresponding transaction.[104]

Shareholders of both closed and open joint-stock companies in certain cases have a priority right on acquisition of the company's shares. In connection therewith, it is required to follow a certain order of enforcing of the right while alienating the shares.[105] Violation of the right on priority acquisition of the shares gives to a shareholder whose rights are violated or to the company to claim in court a transfer of the rights and obligations of a buyer of such shares to the corresponding interested party.

Crossborder Trade

Trade in Russian Securities by Foreigners. Trade in shares and bonds of Russian issuers by non-residents is subject to certain restrictions. Currency regulation restrictions were relaxed as the Central Bank has authorised payments by non-residents in foreign currency for Russian stock.

Acquisition of shares of Russian issuers by foreigners must be reported by the parties to the Federal Securities Market Commission.[106] Transactions with Russian securities outside the Russian Federation are allowed, subject to authorisation by the Federal Securities Market Commission. Article 16 of the Securities Market Law provides that:

> . . . securities issued by the issuers domiciled in the Russian Federation are admitted to circulation outside the Russian Federation on the decision of the Federal Securities Market Commission.

Federal Securities Market Commission Decision Number 7/ps of 22 March 2002 provides that securities of Russian issuers are allowed for circulation outside the Russian Federation without limitations except for two cases. A prior authorisation by the Federal Securities Market Commission is required for initial placement and circulation of Russian securities outside the Russian Federation if such securities will be traded through foreign organisers of trade. Prior authorisation also is required for circulation outside the Russian Federation of Russian securities deposited with a foreign issuer, by means of issue and placement by such foreign issuer of securities, and which certify rights to the Russian securities deposited with him.[107]

Acquisition of the shares of Russian issuers, for which the privatisation is not yet completed (ie, the government holds more than 25 per cent of stock) by non-residents is subject to additional formal requirements.

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104 Civil Code, art 173.
105 Law on Joint-Stock Companies, art 7, item 3, and arts 40 and 41.
106 Securities Market Law, art 29.
107 Federal Securities Market Commission Decision Number 29 of 23 November 2001; Federal Securities Market Commission Decision Number 3 of 13 March 2001.

Trade in Foreign Securities. Trade in foreign securities, other than debt instruments with a maturity term of less than 180 days, has been virtually non-existent in Russia due to currency regulation restrictions. Acquisition of voting shares, convertible shares, and derivative instruments of foreign issuers, subject to some exemptions, is considered to be a capital account operation and requires permission from the Central Bank.

An exemption is made for acquisition of shares by authorised Russian banks, which was allowed by Central Bank Directive Number 193 of 27 March 1998. Another exemption is made for acquisition of shares in companies domiciled in the Commonwealth of Independent States for the amount up to US $10 million.[108]

Recently, the currency regulations were relaxed by allowing Russian residents (natural persons) to transfer foreign currency into or outside the Russian Federation as payment for securities denominated in foreign currency up to US $75,000 per year, without permission from the Central Bank.[109]

Trade in Shares of Russian Banks. Terms of organisation of banks with participation of foreign investments in the Russian Federation were issued by the Letter of the Central Bank of Russia of 8 April 1993, Number 14. Banks acting in the Russian Federation and wishing to increase their charter capital on the account of non-residents' contributions must obtain preliminary consent of the Central Bank. This also applies to sale ('assignment') by shareholders-residents of already-issued shares (existing shares in the capital) to non-residents. Sales or issues of shares of banking institutions to non-residents without permission from the Bank of Russia are invalid and can result in withdrawal of the banking licence.

Disclosure of Acquisition of Substantial Holdings

Shareholder Duties. A holding company is obliged to publish information of acquisition of more than five per cent of the stock of any company (including a holding company's subsidiary) within a week after the execution of the transaction. The failure of a holding company to file notification may be the basis for invalidation of the transaction.

There are certain limitations in respect of the ownership structure and corporate forms of companies in particular industries. Audit firms cannot be created in the form of open joint-stock companies.[110]

Natural monopolies are understood as commodity markets which, due to the nature of the product, function more efficiently in the absence of competition (eg, utility companies and railways). Special regulations apply to transactions with shares of natural monopolies. A person or a group of persons is obliged to notify respective authorities regulating natural monopolies in the case of acquisition of shares which, together with shares

108 Central Bank Regulation Number 142-p of 5 July 2001.
109 Federal Law on the Currency Regulation and Currency Control Number 3615-1 of 9 October 1992, art 6, item 2, as amended by Federal Law Number 72-FZ of 31 May 2001.
110 Federal Law on Auditing Activities Number 119-FZ of 7 August 2001, art 4, item 3.

already owned, gives it a control over more than 10 per cent of the voting stock of a natural monopoly. Such notices must be made within 30 days from the date of the transaction. The same requirement is applied to a natural monopoly which has acquired more than 10 per cent of the voting stock of any company.[111]

Acquisition of more than five per cent of the stock (shares) of a credit organisation by a person or a group of legal and/or physical persons in the course of one or a series of transactions requires notification to the Bank of Russia.[112] Preliminary approval by the Central Bank of Russia is required for acquisition of more than 20 per cent of the shares. The Bank of Russia must inform the applicant in writing of its decision no later than within 30 days from receiving a request for clearing the transaction.

Incorporators of a bank may not cease to be members of the bank within the first three years from the date of its registration.[113] Shareholders who are the founders of a bank do not have a right to sell or assign the shares belonging to them within the mentioned period.

Professional securities market-makers are obliged to disclose certain information about their operations by giving notice to the Federal Securities Market Commission.

Disclosure of acquisition of substantial holdings may entail a duty by the owner to notify the Federal Securities Market Commission or to publish information about its shareholding interest. Any owner must disclose information about his possession of the securities of any issuer by sending notice to the Federal Securities Market Commission when:

- The owner has acquired ownership of 20 per cent or more of any class of securities of a given issuer;
- The owner has increased his share of ownership of a given class of securities beyond a threshold set at each multiple of five per cent of the overall number of securities of the class (in excess of 20 per cent of the class of securities); and
- The owner has reduced his share of ownership of any class of the issued securities of the issuer below a threshold set at each multiple of five per cent of the overall number of securities of the class (in excess 20 per cent of the class of securities).

The owner must disclose the information (containing the name of the owner, the type and state registration number of the securities, the name of the issuer, and the quantity of securities belonging to him) not later than five days after the corresponding event.

A duty to publish information about acquisition of more than 20 per cent of voting stock applies only to legal entities such as joint-stock companies and limited-liability companies. It attaches to such entities in the case of direct acquisition of ownership in respect of more than 20 per cent of the voting shares of other issuers. A company is obliged to publish information about acquiring more than 20 per cent of another

111 Federal Law of 17 August 1995 Number 147-FZ, art 7, item 4.
112 Russian Federation Law of 2 December 1990, art 11, as amended.
113 Russian Federation Law on Banks and Banking Activity, art 11, part 10.

company's voting stock in the manner determined by the Federal Securities Market Commission and the federal antimonopoly authorities.[114]

A person or a group of affiliated persons intending to carry out transactions which would push the cumulative ownership of the target company beyond the threshold of 30 per cent of issued voting shares is obliged to send to the company a written notice of its intention to acquire the shares not earlier than 90 days and not later than 30 days before the date of acquisition of the stock.[115] The rule also applies to acquisition of each five per cent in excess of 30 per cent of voting shares. Companies with less than 1,000 shareholders are exempt from the requirement.

Dependent and Subsidiary Companies. Acquisition of a large shareholding by a person or a group of related persons enables them to control the companies as if they were the sole owners, as well as the possibility to influence decisions of a joint-stock company's management bodies. If, as a result of the acquisition of a large share interest of a company, the latter becomes a dependent or subsidiary company,[116] such transaction may affect ensuring of a joint-stock company's creditors.

A company is dependent if more than 20 per cent of its voting shares is owned by another company. A company is a subsidiary if, by virtue of owning a controlling block of shares or pursuant to an agreement between it and another company or otherwise, another (principal) company can determine the business acts of a subsidiary.

Company Duties. Joint-stock companies and professional participants in the securities market are obliged to notify the Federal Securities Market Commission about acquisitions of a certain portion of shares.[117] In general, any information materially affecting the business of an issuer is subject to periodic disclosure, provided that at least one issue of shares of this issuer was offered publicly, or offered privately to more than 500 persons or for the amount exceeding 50,000 minimum standard wages.

The disclosure has two forms, ie, periodic reporting and notices regarding essential facts. Periodic disclosure encompasses quarterly reports which must include:

- The list of owners (shareholders) of the issuer owning 20 per cent and more of the issuer's shares;
- The list of legal entities 20 per cent or more of whose shares is owned by the issuer; and
- Other data specified in the Law on Securities Market and Federal Securities Market Commission Decision Number 31 of 11 August 1998.

A quarterly report must be submitted to the Federal Securities Market Commission within 45 calendar days after the end of the corresponding quarter. It also must be sent to any of the securities holders on their request at a nominal fee covering reproduction and mailing

114 Federal Securities Market Commission Decree Number 10 of 14 May 1996.
115 Law on Joint-Stock Companies, art 80.
116 Civil Code, arts 105 and 106.
117 Securities Market Law, art 30.

costs. A detailed regulation of quarterly reporting is provided by the Regulations on the Quarterly Reports of Securities Issuers, approved by Decision of the Federal Securities Market Commission Number 31 of 11 August 1998.

Notice must be made by an issuer when its shareholders' register indicates concentration of more than 25 per cent of a certain class of issued securities in the hands of one owner.[118]

Insider Trading and Fraud

Material Rules

Transactions with an Interest. The regulation of 'transactions with an interest' is a device intended to prevent insider transactions and is found in the Law on Joint-Stock Companies. This device is particularly effective in respect of securities offerings and in transactions with treasury stock. A special clearance procedure must be followed for transactions where a company sells its shares and the counter-party (buyer) is deemed to be a 'person with an interest' (an insider). The following persons are deemed to 'have an interest':

- Members of the board of directors (or supervisory board) of the company;
- The general manager, members of the collective executive body of the company or shareholders holding jointly with their affiliated person(s) 20 per cent or more of the voting shares of the company, or persons who may give binding instructions to the company;
- Spouses, parents, children, brothers, sisters, adoptive parents, and adopted children of the persons indicated above;
- Affiliated persons;
- Companies which are 20 per cent or more owned by persons described above; and/or
- Companies wherein above-mentioned persons hold office(s) in management bodies.

In addition, the charter of the company may provide for other cases when a person is deemed to 'have an interest'. A transaction with an interested party must generally be approved prior to entering into it by a majority of votes of directors (supervisory board) of a company who do not have an interest in the transaction. However, the decision is within the exclusive competence of the general shareholders' meeting in the following cases:

- The book value of property sold or the price of property acquired is two per cent or more of the company's assets; and
- The number of voting shares of the company or of other convertible securities conveyed under the transaction or several related transactions exceeds two per cent of the overall number of voting shares previously issued by the company and voting shares into which previously issued securities can be converted.

118 Federal Law on the Securities Market, articles 23 and 30; Federal Securities Market Commission Decision Number 32 of 11 August 1998.

The Securities Market Law expressly provides that insiders, ie, persons possessing proprietary information, cannot use such information for entering into transactions. Such transactions are invalid and unlawful.[119]

Proprietary information is understood to be such data about the issuer and its the securities which is not publicly available and which gives the persons possessing it a competitive advantage *vis-à-vis* other securities market participants.

Russian law protects commercial secrets (ie, information which has actual or potential commercial value, is not publicly available, and is safeguarded by an owner who exercises efforts to maintain its secrecy).

A person who has disclosed or used information constituting a commercial secret in violation of statutory or contractual duty must compensate damages caused by these acts. These rules apply to information in the securities market.

Professional participants in the securities market are obliged to offer to their customers (investors) the following information:

- A copy of the licence for professional activity in the securities market;
- A copy of the document of state registration of the securities market professional;
- Information on the body issuing the licence for professional activity at the securities market (name, address, and telephone numbers); and
- Information on the registered capital, owned assets of the securities market professional, and its reserves.

In case of the failure of a securities market professional to offer or disclose information or in case of provision of incorrect, incomplete, and/or misleading information, the investor has the basis for demanding termination or modification of the contract with the securities market professional and compensation for damages.

Criminal liability is provided by the Criminal Code for persistent failure to provide information to investors and regulatory authorities or the provision of false or incomplete information, if such failures or actions have caused major damage to citizens, organisations, or the state.

Basis of Territorial Link. The basis of a territorial link in cases of insider trading and fraud has not been tested in the courts. However, judging by the overall tradition of the Russian legal system, the law will be applied depending on the nationality (domicile) of an issuer. For companies incorporated in Russia, that will be the law of the Russian Federation; for companies incorporated in other countries, it will be the law of the corresponding country.

119 Civil Code, art 169; Decree of the Presidium of the High Arbitration Court of the Russian Federation of 2 July 1996, Number 757/96.

Extraterritorial Application. The rules on conflict of laws provide two principal rules, depending on the nature of violations. The law of the country where the infringement has taken place applies to torts. The law applicable to contracts is determined in accordance with rules found in article 166 of the Fundamentals of Civil Legislation. Extraterritorial application of Russian laws relating to insider trading has not been tested.

Public Take-Over Bids

Territorial Application (Foreign Bidder–Domestic Target). Take-over regulations apply to all bids for acquisition of domestic targets, regardless of the nationality of the bidder and the seller of stock.

Procedural Requirements. A person or a group of affiliated persons intending to carry out transactions which would push the cumulative ownership of the target company beyond the threshold of 30 per cent of issued voting shares is obliged to send to the company a written notice of intention to acquire the shares not earlier than 90 days and not later than 30 days before the date of acquisition of the stock.[120]

If the bidder succeeds in acquiring, independently or jointly with his affiliated person, 30 per cent or more of issued voting shares of the company, it is obliged within 30 days from the date of acquisition of shares to make a buyout offer to other shareholders. Shareholders have 30 days, from the day they receive an offer to sell their shares to a successful bidder, to accept or refuse it.

The offer to sell shares must include information on the bidder and quote buyout price and the deadline for transfer and payment of shares if the offer is accepted. The buyout price quoted by a successful bidder must be the market price of such shares, but it may not be lower than the average weighted price for the acquisition of stock of the company during the six months immediately preceding the date of the acquisition of 30 per cent or more of the stock of the company by the bidder.

A bidder's failure to comply with the notice or buying offer requirement will not render the transaction invalid. However, the voting power of the bidder will be limited to the number of voting shares, which were acquired in compliance with the take-over regulations. Shares acquired in breach of such regulations will not be taken into account for voting. This rule also applies to acquisition of each five per cent in excess of 30 per cent of voting shares.

Exemptions. Joint-stock companies with 1,000 or less shareholders are exempt from the above take-over regulations.

The application of take-over regulations to a buyout of minority shares may be waived by the charter of a joint-stock company or an *ad hoc* decision of a shareholders' meeting. Shares owned by a successful bidder and its affiliated persons do not count in voting on this issue.

Recognition of Foreign Take-Over Regulation. There is no practice regarding recognition of foreign take-over regulations.

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120 Law on Joint-Stock Companies, art 80.

Singapore

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Singapore

Lee Eng Beng and George Chiong
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Singapore

Introduction

Regulatory System

Prior to 1973, Singapore shared a common stock exchange with its immediate northern neighbour, Malaysia, and there was no statutory regulation of the stock exchange. In 1973, the Stock Exchange of Singapore Ltd, a public limited-liability company, was incorporated.

It was then that the Securities Industry Act 1973, based largely on corresponding Australian legislation, was enacted. However, the Act adopted a largely *laissez- faire* approach, and the Stock Exchange of Singapore Ltd essentially regulated its own affairs and the stockbroking industry.

Legislative overhaul ensued in 1985 when the Pan-Electric group of companies collapsed due to reckless and ill-fated speculation in forward contracts in securities, and the Stock Exchange of Singapore Ltd had to be closed for three days. This debacle prompted the enactment of the new Securities Industry Act, which was again based on Australian legislation. This new regime ended the hitherto effectively self-regulated stockbroking industry.

The Monetary Authority of Singapore was charged with the responsibility of administering the Securities Industry Act, and it was given extensive powers of regulation, supervision, and investigation over the securities industry. Statutory licensing requirements for stockbroking companies, investment advisers, and their representatives also were introduced. Furthermore, more comprehensive rules for the conduct of securities business and the trading of securities were established.

In particular, the influence of the Monetary Authority of Singapore over the Stock Exchange of Singapore Ltd has become apparent under the existing regulatory regime. The Monetary Authority of Singapore has the power to approve amendments to the Stock Exchange of Singapore Ltd rules and listing rules and to issue directions to the Stock Exchange of Singapore Ltd with which the Exchange has a statutory duty to comply.

Furthermore, the Stock Exchange of Singapore Ltd has statutorily obliged to provide reasonable assistance to the Monetary Authority of Singapore for the performance of the latter's functions, and the Monetary Authority of Singapore has the power of review over any disciplinary action taken by the Stock Exchange of Singapore Ltd. While the Stock

Exchange of Singapore Ltd remains very active in regulating and monitoring the securities market and its participants and is probably to be regarded as the primary regulator in practice, all this is done in close consultation with the Monetary Authority of Singapore. On a day-to-day basis, the Stock Exchange of Singapore Ltd maintains responsibility, of course, for the administration and implementation of its internal rules, for example, the listing rules and the rules governing the conduct of securities business by its member stockbroking firms.

Apart from the Securities Industry Act, which is the principal piece of legislation regulating the securities industry, the other relevant piece of legislation is the Company Act, which deals with the general statutory duties of companies and their officers, including public listed companies. The Company Act also contains basic provisions in relation to the specialised field of take-overs and mergers, but essentially delegates authority to a specialised body of rules enacted under the Company Act called the Singapore Code on Take-overs and Mergers. The Securities Industry Council, a statutory body established under the Securities Industry Act, is the principal body responsible for administering the Code.

Legal Sources

In General

Singapore inherited the legal system of her former colonial master — England — and has a Common Law system. The main sources of law are therefore legislation and judge-made law.

However, much of the securities industry is governed by rules which do not have the force of law, chiefly, the rules promulgated by the Stock Exchange of Singapore Ltd. These will be described here as well, since in practice they have as much, if not more, impact on securities trading in Singapore.

Securities Industry Act

The Securities Industry Act is the primary piece of legislation that regulates the securities industry, and one also must take note of the Securities Industry Regulations, which is subsidiary legislation passed under the authority of the Securities Industry Act. Briefly, the Securities Industry Act deals with the following:

- The general powers of the Monetary Authority of Singapore in relation to investigations, inspections, and the obtaining of documentary evidence;
- The establishment and Ministerial approval of securities exchanges;
- The powers of the Monetary Authority of Singapore in relation to the supervision and control of securities exchanges and the trading of securities;
- The licensing of dealers, investment advisers, and their representatives and their duty to maintain a register of interests in securities;
- The conduct of securities business by licensed persons;

- The duty of dealers and investment advisers in relation to the maintenance of proper accounts and audit requirements;
- The establishment and administration of fidelity funds; and
- The prohibition of insider trading, market manipulation, and other securities frauds.

Companies Act

The Companies Act is the basic corporations legislation, and it deals with the fundamental incidents of corporate activity. The Company Act deals with the following aspects which are relevant to the securities industry:

- The public offering of securities and other interests, prospectus requirements, and exemptions;
- The notification requirements and the maintenance of registers in relation to substantial shareholdings;
- The trustee requirements and the maintenance of registers in relation to debentures;
- The establishment and operation of the Central Depository System, the scripless shares trading system used by the Stock Exchange of Singapore Ltd;
- The duties of companies in relation to the holding of meetings, the maintenance of proper accounts, and audit requirements;
- The qualifications and duties of company directors and officers; and
- The conduct of take-overs and mergers.

Code on Take-overs and Mergers

Under the authority of the Company Act, a non-statutory code has been declared to apply to the conduct of take-overs and mergers. The Code on Take-overs and Mergers is similar in nature to the London Code on Take-overs and Mergers, and it is couched in non-technical language. Administered by the Securities Industry Council, the Code supplements the Company Act's basic provisions on the conduct of take-overs and mergers.

The Code essentially contains a number of General Principles and Rules which are to be complied with in the conduct of a take-over or merger of a public company. It does not deal with the commercial merits of a take-over or merger, but it lays down the proper practice to be followed by the parties involved in a take-over and merger, including the following aspects:

- The provision of sufficient time and accurate information and advice to shareholders to decide on the merits of a take-over offer;
- The equality of treatment of shareholders;
- The duties of the directors of the offeror and offeree in relation to the conduct of the take-over or merger;
- The documentation required to accompany a take-over or merger;
- The timetables for the various procedures to be completed during a take-over or merger;

- A prohibition against the use of certain defensive tactics to defeat a take-over;
- The prevention of insider trading and market manipulation; and
- The triggering of an obligation to make a mandatory general take-over offer.

Stock Exchange of Singapore Ltd Rules

In General. There are four bodies of rules prescribed by the Stock Exchange of Singapore Ltd which are of importance, namely:

- The Stock Exchange of Singapore Ltd Memorandum and Articles of Association;
- The Stock Exchange of Singapore Ltd Rules;
- The Stock Exchange of Singapore Ltd Listing Manual; and
- The Stock Exchange of Singapore Ltd Bye-Laws.

Stock Exchange of Singapore Ltd Memorandum and Articles of Association and Stock Exchange of Singapore Ltd Rules. The Stock Exchange of Singapore Ltd Memorandum and Articles of Association and the Stock Exchange of Singapore Ltd Rules are concerned with the internal regulation of the membership of the Stock Exchange of Singapore Ltd.

They deal with the rights and liabilities between the Stock Exchange of Singapore Ltd and the member stockbroking companies and provide for certain internal and disciplinary procedures with respect thereto.

Stock Exchange of Singapore Ltd Listing Manual. The Stock Exchange of Singapore Ltd Listing Manual, on the other hand, contains the rules with which companies the securities of which are listed on the Stock Exchange of Singapore Ltd are contractually obliged to comply.

Stock Exchange of Singapore Ltd Bye-Laws. Finally, the Stock Exchange of Singapore Ltd Bye-Laws contain comprehensive provisions dealing with the conduct of securities trading business on the Stock Exchange of Singapore Ltd.

Common Law

The Supreme Court of Singapore comprises of the Court of Appeal and the High Court. The former is the highest court in Singapore, appeals to the Privy Council in England having been abolished in 1994. The law as laid down in the decisions of the High Court and the Court of Appeal is binding in Singapore. However, perhaps due to the size of the jurisdiction, to date there have not been many Singapore decisions in relation to securities regulation.

Where a situation is not covered by law laid down by the Singapore courts, reference may be made to case law from other Commonwealth jurisdictions. For example, English cases are treated with respect and regarded as highly persuasive in Singapore. Furthermore, in

the context of securities regulation and company law, decisions from Australia may be relevant where they relate to statutory provisions which are identical or similar to the corresponding Singapore provisions.

Authorities

In General

The main regulatory authorities in relation to the securities industry in Singapore are:

- The Monetary Authority of Singapore;
- The Stock Exchange of Singapore Ltd;
- The Securities Industry Council;
- The Registry of Companies; and
- The Commercial Affairs Department.

Monetary Authority of Singapore

The Monetary Authority of Singapore is a body corporate established by statute. It is the *de facto* central bank of Singapore and has general supervisory powers over the securities, insurance, banking, and futures sectors. In relation to the securities industry, the Monetary Authority of Singapore is the primary regulator with wide statutory powers conferred by the Securities Industry Act, a brief description of which has been set out above.

However, as also pointed out above, in practice, it is the Stock Exchange of Singapore Ltd that has assumed the responsibility to deal with most regulatory matters in relation to the securities industry, although no doubt in close consultation with the Monetary Authority of Singapore.

Stock Exchange of Singapore Ltd

The Stock Exchange of Singapore Ltd, a public limited-liability company, was incorporated in 1973, and it remains the only licensed stock exchange in Singapore. Its members are the stockbroking companies, and the Stock Exchange of Singapore Ltd regulates closely the constitution and operations of its members through the Memorandum and Articles of Association and the Stock Exchange of Singapore Ltd Rules.

The Stock Exchange of Singapore Ltd also regulates the conduct of securities trading business by the stockbroking companies and their representatives through the Stock Exchange of Singapore Ltd Bye-Laws.

The Stock Exchange of Singapore Ltd maintains two boards, the Main Board and the Stock Exchange of Singapore Dealing and Automated Quotation System (SESDAQ). SESDAQ, which was established in 1987, has less stringent listing criteria in comparison to the Main Board, and it is designed for local stocks with a smaller capitalisation and a shorter track record.

Until September 1999, the Stock Exchange of Singapore Ltd also maintained a Foreign Board for the purpose of providing access for promising foreign enterprises that have good prospects for profitability but have yet to meet the criteria for listing on the Main Board. The Foreign Board has since been abolished, and foreign enterprises are now able to list on the Main Board or SESDAQ, depending on their track record or size. All the companies the securities of which are listed on the Stock Exchange of Singapore Ltd boards are contractually bound to comply with the Stock Exchange of Singapore Ltd Listing Manual, the provisions of which are administered and enforced by the Stock Exchange of Singapore Ltd.

The powers of the Stock Exchange of Singapore Ltd in relation to the enforcement of the Stock Exchange of Singapore Ltd Listing Manual are, therefore, basically contractual in nature, although there is statutory provision allowing applications to the court to enforce the provisions of the Listing Manual.

The Stock Exchange of Singapore Ltd also maintains a market linkage with the National Association of Securities Dealers (NASD) in the United States. This system allows for the trading of stocks quoted on NASDAQ to be bought or sold through the Stock Exchange of Singapore Ltd.

The Stock Exchange of Singapore Ltd further provides an over-the-counter market for trading in the securities of foreign companies called 'CLOB International'. These securities are not listed on the Stock Exchange of Singapore Ltd and Singapore brokers make a market for such shares. Accordingly, these foreign

companies are not obliged to comply with the Stock Exchange of Singapore Ltd Listing Manual and the Stock Exchange of Singapore Ltd has no regulatory powers over them.

The bulk of the securities that were traded on CLOB International used to be the securities of Malaysian companies shares but trading in such securities halted abruptly recently when the Kuala Lumpur Stock Exchange of Malaysia announced that it regarded the market as illegal and that it would not recognise such trades. The Malaysian securities formerly traded on CLOB International are now frozen by the Kuala Lumpur Stock Exchange, and the crisis has yet to be resolved.

Securities Industry Council

The Securities Industry Council is a body established under the Securities Industry Act, and it consists of representatives of business, government, and the Monetary Authority of Singapore as the Minister of Finance may appoint. Its general function is to advise the Minister of Finance on all matters relating to the securities industry. The Monetary Authority of Singapore also may consult the Securities Industry Council for the proper and effective implementation of the Securities Industry Act.

The specific and practically most significant function of the Securities Industry Council is to administer the Singapore Code on Take-overs and Mergers. In this connection, however, the Securities Industry Council has few statutory powers and performs this function in a way somewhat similar to the approach of the celebrated London Panel on Take-overs and Mergers.

Registry of Companies

The Registry of Companies is the statutory body established under the Company Act which is responsible for maintaining statutory records of local and foreign companies carrying on business in Singapore.

In the realm of securities regulation, the key function of the Registry of Companies is to regulate the form and contents of prospectuses for securities issues and the statutory statements and documents required to be issued in a take-over.

Commercial Affairs Department

The Commercial Affairs Department is a department of the Ministry of Finance, and it is charged with the responsibility of investigating and prosecuting offences under the Securities Industry Act and the Company Act.

Legal Order and Regulatory Interests

Admission

Market Participants

Domestic Exchanges. As stated above, there is only one domestic securities exchange in Singapore, which is operated by the Stock Exchange of Singapore Ltd. The Stock Exchange of Singapore Ltd is a public company limited by shares incorporated under the Company Act and its members are the stockbroking firms through which securities are traded on the Stock Exchange of Singapore Ltd.

Various forms of securities may be listed and traded on the Stock Exchange of Singapore Ltd, including equity securities, equity-linked securities, such as warrants, and debt securities, such as bonds, debentures, loan stock, and notes.

Virtually all the securities traded on the Stock Exchange of Singapore Ltd are in electronic 'book-entry' form rather than scrip form. The scripless securities accounts and the central book-entry clearing system are operated by the Central Depository (Pte) Ltd.

Transborder Electronic Trading Systems. There is no transborder electronic trading system operating in Singapore.

Off-Market Transactions. Transactions in scripless securities may be effected 'off-market' in 'married deals' through brokers, when a seller and buyer are matched not through the market but through one or more brokers.

In such a situation, securities from one account may be transferred directly to another account without going through the market. Alternatively, an investor may withdraw his scripless securities from the Central Depository (Pte) Ltd, receive them in scrip form, and then enter into a transaction 'off-market'.

Securities

Issuer Requirements. Both local and foreign equity securities may be listed on the Main Board of the Stock Exchange of Singapore Ltd. Securities designated for listing may be denominated in Singapore dollars or foreign currencies (with certain qualifying restrictions for local equity securities).

Local issuers also have the option of listing on SESDAQ which, as described earlier, is a market established to enable companies that do not yet meet the requirements for a Main Board listing to raise funds from the stock market. Prior to September 1999, foreign equity securities had the option of listing on the Foreign Board, which was a market established to enable foreign enterprises that do not yet meet the requirements for a Main Board listing to raise funds from the stock market. The Foreign Board has since been abolished, and foreign enterprises are now able to list on the Main Board or SESDAQ, depending on their track record or size.

Requirements for Primary Listing on the Stock Exchange of Singapore Ltd Main Board. Both local and foreign corporations may seek a primary listing on the Stock Exchange of Singapore Ltd. An issuer applying for the primary listing of its equity securities on the Main Board is generally required to meet the following requirements:

- In the case of companies with a market capitalisation of S $300 million or less, at least 25 per cent of its issued and paid-up capital is to be in the hands of not less than 1,000 shareholders;
- In the case of companies with a market capitalisation of more than S $300 million, the percentage of shares which are to be in the hands of not less than 1,000 shareholders is at the discretion of the Stock Exchange of Singapore Ltd, subject to a minimum of 10 per cent;
- It must satisfy one of the following three criteria in relation to its track record: (a) cumulative consolidated pre-tax profit of not less than S $7.5 million for the last three years and a minimum pre-tax profit of not less than S $1 million for each of those three years, (b) an aggregate pre-tax profit of not less than S $10 million for the preceding one or two years, or (c) market capitalisation of not less than S $80 million calculated based on issue price and post-floatation issued capital;
- The group must be in a healthy financial position with no shortfall in working capital;
- A subsidiary or parent company of an existing listed issuer will not normally be considered suitable for listing if the assets and operations of the applicant are substantially the same as those of the existing listed issuer; in arriving at a decision, the Stock Exchange of Singapore Ltd will consider the applicant's business or commercial reasons for listing; and
- There must not be other factors which make a primary listing unsuitable, for example, the make-up of the management of the company and the character and integrity of the directors and management and controlling shareholders of the company, the vulnerability of the company to specific factors or events, and the percentage of related-party transactions which are unable to be removed.

Requirements for Secondary Listing on the Stock Exchange of Singapore Ltd Main Board. The equity securities of an issuer seeking a secondary listing on the Stock Exchange of Singapore Ltd must already be quoted or will be quoted concurrently on the issuer's home exchange or an overseas stock exchange, and there must be an open market in the securities for which listing is sought. The issuer is expected to have at least 2,000 shareholders worldwide.

Requirements for a Listing on SESDAQ. An issuer applying for listing of its equity securities on SESDAQ need not meet any minimum profit or share capital requirements. However, the Stock Exchange of Singapore Ltd will consider various factors, such as the integrity of the management and controlling shareholders, the prospects of the company, and whether there are any conflicts of interest.

An issuer applying for the primary listing of its securities on SESDAQ is generally required to meet the following requirements:

- While there are no minimum profit or share capital requirements, a company with no track record at all will normally be expected to show that it requires funds to finance a project or the development of a new product, which must have been fully researched and costed;
- At least 500,000 shares or 15 per cent of the issued and paid-up capital (whichever is the greater) should be held by not less than 500 public shareholders;
- The company must be engaged in a business which is expected to be viable and profitable, with prospects for future growth and expansion;
- A company listed on SESDAQ may be considered for transfer to the Main Board after it has been listed for at least two years on SESDAQ and meets the minimum share capital and track record requirements applicable to Main Board Companies.

Listing of Local Debt Securities. In relation to an application for the listing of an issue of local debt securities by an issuer whose equity securities are listed on the Stock Exchange of Singapore Ltd, the issue of debt securities must have a nominal value of at least S $750,000 and be held in the hands of at least 100 holders. In relation to an application from an issuer whose equity securities are not listed on the Stock Exchange of Singapore Ltd, the issuer also is expected to be able to meet the Stock Exchange of Singapore Ltd's requirements for the listing of equity securities.

Listing of Foreign Debt Securities. An issuer seeking to list its foreign debt securities is expected to be:

- A supranational body;
- A government, or a governmental agency whose obligations are guaranteed by a government;
- A corporation which has a cumulative consolidated pre-tax profit of at least S $50 million for the last three years, or a minimum pre-tax profit of S $20 million for any one of the three years, and consolidated net tangible assets of at least S $50 million; or

- A corporation whose obligations under the issue are guaranteed by a corporation which meets any of the above requirements.

The minimum number of holders of the debt securities should not be less than 100.

Listing of Investment Funds. An investment fund applying for listing should comply with the following requirements:

- An investment fund denominated in Singapore dollars should have a minimum asset size of at least $20 million and at least 25 per cent of the investment fund's share capital or units should be held by at least 500 public shareholders (100 in the case of a venture capital fund);
- An investment fund denominated in a foreign currency should have a minimum asset size of US $20 million, and a spread of holders necessary to enable an orderly market in the shares or units of the fund to develop, and may be required to establish facilities for the transfer and registration of shares or units in Singapore;
- An investment fund denominated in Singapore dollars must comply with certain restrictions, such as caps on investments in companies related to the fund's substantial shareholders and investments in unlisted securities;
- A newly formed investment fund should not change its investment objectives and policies in the first three years unless otherwise approved by shareholders through a special resolution in a general meeting; and
- The management company and the persons managing the investments of the investment fund must be reputable and have a track record of at least five years, with satisfactory experience in managing the particular types of funds for which listing is sought.[1]

Securities Requirements. There are certain restrictions on the form of securities which may be issued in Singapore. These restrictions are contained in the Company Act and, in the case of securities listed on the Stock Exchange of Singapore Ltd, in the Stock Exchange of Singapore Ltd Listing Manual.

Under the Company Act, a company incorporated in Singapore is not permitted to issue bearer share warrants, which are warrants which state that the bearer of the warrant is entitled to the shares specified therein and which enable the shares to be transferred by delivery of the warrant. Furthermore, options granted in respect of shares in public companies must have an exercise period of not more than five years; otherwise, the option is void.

This stipulation does not apply to certain employee share option offerings, for which the exercise period may be 10 years, and does not apply in the case where holders of debentures have an option to take up shares of the company by way of redemption of the debentures.

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1 A venture capital fund is exempted from complying with certain restrictions on investments, such as the cap on investments in unlisted companies, but such an investment fund should be offered for sale and be quoted for trading in denominations of at least S $5,000.

Prospectus Requirements. Under the Company Act, a prospectus is required to be registered with the Registry of Companies before securities may be offered to the public in Singapore. There is no statutory definition of what constitutes the 'public' under Singapore law. It is a question of fact to be determined by reference to all the material circumstances of each case.

The relevant factors which may be considered include the number of persons the securities are offered to, the relationship or nexus between the offeror and the offerees, and the nature of the offer. Generally, it may be prudent to consider an offer to more than 15 to 20 persons in Singapore as an offer to the public in Singapore, unless there are very persuasive reasons to reach a different conclusion.

The prospectus must comply with the requirements of the Company Act, which are fairly extensive, as to its form and content. These include the following:

- Particulars of all the directors or proposed directors of the issuer;
- Nature of the company's business and names of related corporations;
- Particulars of any property which is to be purchased or acquired by the company and which is to be paid for wholly or partly out of the proceeds of the issue;
- Particulars of every material contract, not being a contract entered into in the ordinary course of the company's business, entered into in the two years preceding the date of issue of the prospectus;
- Particulars of the nature and extent of the interest of every director and expert in the promotion of the company or the property proposed to be acquired by the issuer;
- A report by an approved company auditor together with the relevant financial statements for the preceding five financial years, to be dated no more than nine months (unless otherwise extended by the Registrar) before the issue of the prospectus; and
- A report by the directors as to whether, after due inquiry by them in relation to the interval between the date to which the last accounts have been made up and a date not earlier than 14 days before the issue of the prospectus, (a) the business of the corporation and its subsidiaries has in their opinion been satisfactorily maintained, (b) there have in their opinion arisen since the last annual general meeting of the corporation any circumstances adversely affecting the trading or the value of the assets of the corporation or any of its subsidiaries, (c) the current assets of the corporation and of its subsidiaries appear in the books at values which are believed to be realisable in the ordinary course of business, (d) there are any contingent liabilities by reason of any guarantees given by the corporation or any of its subsidiaries, or (e) there are, since the last annual report, any changes in published reserves or any unusual factors affecting the profit of the corporation and its subsidiaries.

If the securities are equity securities proposed to be listed on the Stock Exchange of Singapore Ltd, the prospectus must contain further categories of information, including:

- Issue statistics, including net tangible assets before and after flotation, premium, or discount of the issue price over the net tangible assets per share before and after flotation, historical and prospective net earnings per share and issue price earnings ratio, and forecast dividend and dividend cover;

- Particulars of directors, promoters, and executive officers, including details on past convictions (if any), option schemes, aggregate remuneration paid to directors in the last financial year, terms of existing and proposed service contracts, and interests of directors and substantial shareholders in equity securities of the issuer;
- Detailed history and business of the issuer, including description of major customers and suppliers, competition in the industry, full and candid disclosure of specific factors to which the issuer is vulnerable, and information on transactions involving related parties and any conflicts of interest;
- Particulars of total borrowings and indebtedness and contingent liabilities, and a statement by the directors that in their opinion the working capital is sufficient or, if not, how the additional working capital thought by the directors to be necessary will be provided;
- Discussion on past earnings and trading and financial prospects; and
- Information on pending or threatened litigation or arbitration proceedings.

A rights issue which is renounceable in favour of persons other than existing members or debenture holders of the company and in respect of which an application is made for permission to list the securities on a stock exchange is deemed to be an offer to the public for which an abridged prospectus must be registered. Advertisements which contain information in excess of certain prescribed categories are deemed to be prospectuses, with the attendant requirements as to form and content and liability for misstatements in prospectuses.

An exemption from the requirements as to the form and content of a prospectus relating to shares or debentures may be obtained from the Registrar. The Registrar may make such an order either unconditionally or on such terms and conditions as he may think fit to impose. An exemption order may be made by the Registrar if he is of the opinion that compliance with the requirements in respect of which exemption has been applied for would be unduly burdensome.

The Registrar also may make an exemption order if the securities are shares or debentures denominated in a currency other than Singapore dollars and issued by a body corporate incorporated outside Singapore, or by a foreign government or an international organisation, and an application is being made for the securities to be listed or quoted on an approved stock exchange in Singapore, if the Registrar is of the opinion that compliance with the particular requirement is unnecessary for the protection of persons who may normally be expected to buy or deal in those securities, being persons who are sufficiently expert to understand the risks involved.

If the securities to be offered to the public comprise debentures, in addition to the prospectus requirements, a trustee corporation approved by the Registrar must be appointed as trustee for the holders of the debentures pursuant to the debentures or in a trust deed relating to the debentures, unless the issuer is a prescribed corporation (defined to mean a banking corporation or a corporation or class of corporation which has been declared by the Minister by notification in the *Government Gazette*).

Exemptions from Prospectus Requirements. There are certain exemptions to the prospectus registration and trustee corporation requirements of the Company Act,

contained in Division 5A of the Company Act. These include the exemptions in the following circumstances, where such offers would otherwise be deemed to be offers to the public and would require the registration of a prospectus (and, if applicable, the appointment of a trustee corporation):

- Offers of shares or debentures pursuant to an offer to enter into an underwriting agreement;
- Certain offers made to existing members or debenture holders of a corporation and which relate to shares in or debentures of that corporation;
- Offers made in connection with a take-over scheme made in compliance with the Company Act;
- Offers made in accordance with a certain employee share investment scheme (including a share option scheme);
- Offers of shares or debentures which have not been previously issued and are uniform in all respects with shares and debentures previously issued and listed on a stock exchange (a statement of material facts in accordance with a prescribed format in the Company Act would have to be registered in place of a prospectus);
- Offers of debentures by a body incorporated in a country outside Singapore where the offer is made by a recognised dealer to such institutional, professional, or business investors as the Minister of Finance of Singapore may specify, being persons or bodies that appear to him sufficiently expert to understand any risk involved in buying or selling those debentures (subject to certain conditions, including the condition that the debentures are denominated in a currency other than the Singapore dollar that is equivalent in value to at least US $5000);
- Offers of debentures made by or guaranteed by the Government of Singapore or an international financial institution of which Singapore is a member;
- Offers of shares or debentures where, on the application of any person interested, the Minister of Finance declares that the cost of providing a prospectus outweighs the resulting protection to investors, or otherwise it would not be prejudicial to the public interest if a prospectus were dispensed with; and
- Offers of shares or debentures to institutional or sophisticated investors.

The exemptions for offers of shares or debentures to institutional or sophisticated investors are commonly invoked. Offers of shares or debentures, whether or not previously issued, to the following institutional investors, who, or which, pursuant to the offer, acquire the shares or debentures as principal or as a trustee for accounts fully managed by it, shall not require the registration of a prospectus (and, if applicable, the appointment of a trustee corporation):

- A licensed bank or merchant bank;
- A registered insurance company or trust company;
- The Government of Singapore or a statutory board;
- A person whose ordinary business it is to buy or sell shares or debentures;
- A licensed investment adviser;

- A pension fund or unit trust;
- An investment company or an approved fund manager; and
- Such other persons as the Minister for Finance of Singapore may declare to be exempt purchasers.

Similarly, offers to sophisticated investors, subject to the following conditions, shall not require the registration of a prospectus (and, if applicable, the appointment of a trustee corporation):

- The offer is not made to more than 50 sophisticated investors;
- The offer is not accompanied by an advertisement offering or calling attention to the offer or intended offer, which is defined to mean a written or printed communication, a communication by radio, television, or other communication medium, or a communication by means of a recorded telephone message published in connection with the offer, but does not include an information memorandum, which is defined to mean a document lodged with the Registrar describing the business and affairs of the issuer and prepared for sophisticated investors to assist them in making an investment decision;
- No selling or promotional expenses are paid or incurred in connection with the offer other than those incurred for administrative or professional services or incurred by way of commission or fee for services rendered by a dealer or investment adviser; and
- The offeror has not invoked the exemption in the preceding 12 months.

A sophisticated investor is defined to mean:

- A person who acquires the shares or debentures, pursuant to the offer, as principal if the aggregate consideration for the acquisition is not less than S $200,000 or its equivalent in foreign currencies for each transaction, whether such amount is paid for in cash, or by exchange of shares or other assets;
- A person who acquires the shares or debentures pursuant to the offer as principal and whose total net personal assets exceed S $1 million or its equivalent in foreign currencies, or whose income in the preceding 12 months is not less than S $200,000 or its equivalent in foreign currencies;
- A corporation whose total net assets exceed S $5 million in value or its equivalent in foreign currencies as determined by its last audited balance sheet; or
- An officer of the offeror or a spouse, parent, brother, sister, son, or daughter of that officer or of the person making the offer, if he is a natural person.

Offers of Participatory Interests. Offers of participatory interests are governed by a separate regime in the Company Act. Participatory interest includes a right to participate or interest in any investment contract, which is defined to mean any contract, scheme, or arrangement which in substance involves the investment of money in circumstances that the investor acquires an interest in or right in respect of property. Common examples of such interests include unit trusts and investment funds.

Before the issue or offer of interests to the public, a statement similar in nature to a prospectus must be issued, which is treated for all purposes as a prospectus (with the attendant procedural requirements and liability for misstatements). The particulars required in the statement include:

- Relevant particulars of the deed constituting the interests;
- Particulars of the management company and its directors;
- Particulars of the undertaking, scheme, enterprise, or investment contract in respect of which the interest is to be issued or offered to the public and the general nature of the property to which the interest relates;
- Nature of the interest to be issued or offered and of any units or sub-units into which the interest is divided and the rights in relation thereto of the persons who come holders thereof;
- Method of calculation provided by the deed of the price at which the management company may sell the interest or any right in respect thereof or any unit or sub-unit of the interest;
- Obligations imposed on the management company or any other person to purchase from any holder the interest or any rights in respect thereof of the interest for which he has subscribed or purchased, and a statement of the method provided by the deed for the calculation of the purchase price;
- Information as to whether the interests or any rights in respect thereof are transferable by the holders thereof and, if so, a summary of the provisions of the deed regulating such transfer; and
- Particulars of every other undertaking, scheme, enterprise, or investment contract involving the issue of interests to the public conducted by the management company within the five years immediately preceding the date of the statement.

Corporate Governance. Under the Company Act, a listed company incorporated in Singapore is required to have an audit committee. The audit committee is to be appointed by the directors from among their number and shall be composed of not fewer than three members, of which a majority may not be:

- Executive directors of the company or any related corporation;
- Family members of an executive director of the company or of any related corporation; or
- Any person having a relationship which, in the opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the functions of an audit committee.

In May 1998, the Stock Exchange of Singapore Ltd introduced a Best Practices Guide which incorporates the views of financial market participants on the principles and practices which listed issuers should endeavour to adhere to. Compliance with the principles and practices set out in the Best Practices Guide is encouraged, but not compulsory.

However, shareholders should be provided with adequate understanding of listed issuers' corporate governance standards. The Stock Exchange of Singapore Ltd also requires each

listed issuer to disclose in its annual report whether, and how, it has complied with the principles and best practices in the Best Practices Guide. The disclosure should include the listed issuer's corporate governance processes and activities.

The Listing Manual requires each listed issuer to set up an Audit Committee which reports to the Board of Directors. The Best Practices Guide sets out the parameters within which the Audit Committee is expected to perform:

- The Audit Committee is expected to serve as a useful channel of communication between the Board of Directors and the external auditors on matters related to and arising out of the external audit;
- The Audit Committee, when making decisions, should have the benefit of the views of members who are independent of management;[2]
- The Audit Committee should have full access to and cooperation by the management, including internal auditors, and have full discretion to invite any director and executive officer to attend its meetings;
- The Audit Committee should be given reasonable resources to enable it to discharge its functions properly; and
- The Audit Committee should review with the internal and external auditors their findings on their evaluation of the listed issuer's system of internal controls.[3]

The Best Practices Guide recommends that listed issuers devise and adopt their own internal compliance codes to provide guidance to their officers with regard to dealings by officers in relation to the issuers' securities. Listed issuers also are encouraged to remind their officers of the prohibitions against insider dealing as set out in the Securities Industry Act.

Officers are expected to refrain from dealing in their companies' securities on short-term considerations, and during the period commencing one month before the announcement of annual or half-year results to the date of the announcement of the results.

The Listing Manual also sets out guidelines on the appointment of auditors. A listed issuer is expected to appoint a suitable accounting firm to meet its audit obligations. In determining the suitability of an accounting firm as auditor, regard should be given to the adequacy of the resources and experience of the accounting firm and the persons assigned to the audit, taking into account the firm's audit engagements, the size and complexity of the listed group being audited, and the number and experience of supervisory and professional staff assigned to the particular audit. The audit partner in charge must be named in the company's annual report, and the partner must be changed at least once every five years.

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2 For this purpose, a majority of members of the Audit Committee, including its chairman, should be independent of management. The Board can consider a director as independent if any relationship he may have would not, in the individual case, be likely to affect the director's exercise of independent judgment.

3 The review would assist the Board in developing policies that would enhance the controls and operating systems of the listed issuer.

Other than in certain exceptional cases, a listed issuer is expected to engage the same auditing firm based in Singapore to audit its accounts and those of its Singapore-incorporated subsidiaries and associated companies.

Registration of Public Offerings. Under the Company Act, a prospectus is required to be registered with the Registrar of Companies before securities may be offered to the public in Singapore.

If the securities to be offered to the public comprise debentures, in addition to the prospectus requirements, a trustee corporation approved by the Registrar must be appointed as trustee for the holders of the debentures pursuant to the debentures or in a trust deed relating to the debentures, unless the issuer is a prescribed corporation. A prospectus need not be registered if an exemption is invoked under Division 5A of the Company Act.

In relation to an offer to the public of participatory interests, a statement similar in nature to a prospectus must be issued, which is treated for all purposes as a prospectus.

If the securities are proposed to be listed on the Stock Exchange of Singapore Ltd, a listing application in compliance with the requirements set out in the Listing Manual will have to be made.

Registration of Placements. There is no separate regime in Singapore governing the registration of placements of securities. However, the prospectus registration requirements in the Company Act may be dispensed with when invoking an exemption under Division 5A of the Company Act, for example, in an offer of securities to sophisticated or institutional investors.

Private placements of securities which do not amount to a public offer of securities need not comply with the prospectus registration requirements of the Company Act.

Registration of Secondary Trade. When securities acquired under the exemption in Division 5A of the Company Act relating to offers to sophisticated and institutional investors are first sold, unless the securities are sold to sophisticated or (as the case may be) institutional investors, the offer for sale is considered an offer to the public unless the shares are listed on an approved stock exchange and certain conditions are met.

Apart from the foregoing, there is no system of registering secondary trade in Singapore.

Periodic Disclosure

In General

An issuer with a primary listing on the Stock Exchange of Singapore Ltd must comply with the continual listing requirements set out in the Listing Manual. The requirements relating to disclosure are summarised below.

Immediate Announcements

The following must be immediately announced to the Stock Exchange of Singapore Ltd for public release:

- Any information known to the issuer concerning itself or its subsidiaries or associated companies necessary to avoid the establishment of a false market in the issuer's securities or which would be likely to materially affect the price of its securities;
- Change of address, proposed alteration of memorandum and articles of association, notice of substantial shareholdings or changes thereof received by the issuer, and calls to be made on partly paid share capital;
- Appointment or resignation of directors, chief executive officers, general manager or executive officers of equivalent rank, company secretary, registrar, or auditors of the issuer;
- Date, time, and place of any general meeting;
- Acquisition and realisations of assets above certain thresholds;
- Application filed in court for the winding up of the issuer or its subsidiaries, or the appointment of a receiver, judicial manager, or liquidator of the issuer or its subsidiaries;
- Recommendation or declaration of a dividend; and
- Books closure.

Financial Statements and Annual Report

The Listing Manual requires that a financial statement for the first half of the financial year and a financial statement for the full financial year in the specified format is to be provided no later than three months after the relevant financial periods.

An annual report also is to be issued within six months of the end of the issuer's financial year.

Take-Overs

A listed issuer which is involved in a take-over offer must comply with the detailed procedures set out in the Listing Manual. The Listing Manual sets out particulars which must be included in all offer documents, in addition to the requirements set out in the Singapore Code on Take-overs and Mergers.

A listed issuer also is required to submit to the Stock Exchange of Singapore Ltd drafts of all circulars and announcements to be issued by the issuer to holders of its securities in connection with a take-over offer.

Acquisitions and Realisations

According to the size of the acquisition or realisation relative to the assets of the issuer, the issuer must comply with certain requirements in the Listing Manual. Generally speaking, an acquisition or realisation which amounts to five per cent to 20 per cent of the issuer's

assets may oblige the issuer to furnish the Stock Exchange of Singapore Ltd with an announcement for public release concerning the details of the transaction.

A transaction which exceeds 20 per cent of an issuer's assets requires an announcement, and must be made conditional on shareholders' approval at a general meeting, and a circular must be sent to all shareholders. A transaction amounting to 100 per cent or more of the issuer's assets or which would result in a change of control of the issuer will also be subject to the approval of the Stock Exchange of Singapore Ltd, and listing of the securities may be suspended during the relevant time.

Corporate Disclosure Policy

A listed issuer is expected to keep the Stock Exchange of Singapore Ltd and shareholders informed of any material information relating to the group which:

- Is necessary to appraise the position of the group;
- Is necessary to prevent the establishment of a false market in its securities; or
- Might reasonably be expected to materially affect market activity in and the price of its securities.

Material information is any information of a factual nature relating to the business and affairs of a listed issuer that will have an effect on the market price or value of the issuers' securities. Examples of such information include information, known to the issuer, concerning the issuer's property, assets, business, financial condition, and prospects and mergers and acquisitions.

Occasionally, a listed issuer may temporarily refrain from publicly disclosing material information, provided that complete confidentiality is maintained, where:

- Immediate disclosure would prejudice the ability of the listed issuer to pursue its corporate objectives;
- The facts are in a state of flux and a more appropriate moment for disclosure is imminent; or
- The listed issuer is holding negotiations and has not reached an agreement in principle.

Where rumours or reports indicate that material information has been leaked, a frank and explicit announcement is required. If rumours are in fact false or inaccurate, they should be promptly denied or clarified.

A listed issuer is expected to monitor the trading in its securities to detect any unusual trading activity. The Stock Exchange of Singapore Ltd also monitors trading, and if it appears that any unusual trading activity cannot be explained by known factors, the Stock Exchange of Singapore Ltd will normally require the listed issuer to make an announcement promptly, stating whether the issuer and its directors are aware of the reasons for the unusual trading activity and whether there is any material information which has not been publicly disclosed.

Foreign Issuers with Secondary Admission

A listed issuer with a secondary listing of its equity securities on the Stock Exchange of Singapore Ltd must simultaneously provide the Stock Exchange of Singapore Ltd with any announcement released to its home exchange or primary exchange.

Apart from the foregoing, the other continuing listing requirements applicable to listed issuers with a primary listing on the Stock Exchange of Singapore Ltd are not applicable to issuers with a secondary listing on the Stock Exchange of Singapore Ltd.

Privileged 'Foreign Private' Issuers

There is no concept of 'foreign private' issuer in relation to compliance requirements set out in the Company Act, in terms of the definition adopted by the Securities and Exchange Commission in the United States.

However, the Registrar of Companies may make an exemption order as to the form and content of a prospectus, if the securities are shares or debentures denominated in a currency other than Singapore dollars and issued by a body corporate incorporated outside Singapore, or by a foreign government or an international organisation, and an application is being made for the securities to be listed or quoted on an approved stock exchange in Singapore.

Apart from the different listing criteria set out in the Stock Exchange of Singapore Ltd Listing Manual for local and foreign securities (as discussed above), there is no concept of 'foreign private' issuer recognised by the Stock Exchange of Singapore Ltd.

Trading Rules

Securities Offerings

Offers of Shares and Debentures. Offers of securities by issuers can either be public or private offers. A company which is incorporated under Singapore law as a private company is prohibited from making any offers of its shares and debentures to the public. Such a company may only make private offers of its shares and debentures, and no regulatory requirements apply to such private offers.

Other types of entities are permitted to invite the public to subscribe for its shares and debentures, subject to a prospectus requirement. Singapore companies incorporated as public companies are permitted to invite the public in Singapore to subscribe for its shares and debentures, provided that such invitation is accompanied by a prospectus.

A foreign company also may, subject to the law of incorporation, make public offers of its shares and debentures in Singapore provided the prospectus requirement is fulfilled. The foreign company need not be registered under Singapore law if it is not carrying on business in Singapore. The mere establishment of a share transfer or share registration office in Singapore to become a listed corporation does not amount to the carrying on of business in Singapore.

Furthermore, a person who holds shares or debentures in any corporation also may offer the shares and debentures for sale to prospective purchasers. Such an offer for sale can be made to the public only if a prospectus is issued. Of course, the holder of the shares or debentures also can make a private offer for sale, and no regulatory requirements will apply to the making of such private offers.

A public offer of shares or debentures must be accompanied by a prospectus. Any application form for shares or debentures in a corporation which is issued, circulated, or distributed to the public must be accompanied by a prospectus. Any invitation made to the public to deposit money with or lend money to a corporation also must be accompanied by a prospectus. The failure to issue a prospectus when one is required constitutes an offence. The contracts made in pursuance of an offer to the public which are made in contravention of the prospectus requirement may be set aside as being illegal and unenforceable.

There is a general prohibition against 'share hawking'. It is an offence for a person to go from place to place, whether by appointment or otherwise, offering shares for subscription or purchase to the public or seeking or receiving offers to subscribe for or to purchase shares from the public. This is irrespective of whether a prospectus has been issued.

Public Offers of Other Interests. Companies incorporated under Singapore law as public companies and foreign companies which are public companies under the law of a proclaimed country and which are registered as foreign companies in Singapore may issue public offers of interests other than shares and debentures. These interests are rights to participate or interests in the following:

- Any profits, assets, or realisation of any financial or business undertaking or scheme, whether in Singapore or elsewhere;
- Any common enterprise whether in Singapore or elsewhere in which the participant is led to expect profits, rent, or interests from the efforts of the promoter of the enterprise or a third party; and
- Any investment contract, ie, any contract, scheme, or arrangement involving the investment of money such that the investor acquires or may acquire an interest in or right in respect of the property used or employed in common with any other interest in or right in respect of property acquired in or under like circumstances.

However, the above rights and interests are defined to exclude:

- Any share in or debenture of a corporation;
- Any interest in or arising out of a policy of life insurance; and
- Any franchise (not being a unit trust scheme or an investment contract).

Such public offers of interests are subject to two main regulatory requirements. First, the offeror must issue a written statement in connection with the public offer which complies with the requirements of a prospectus applicable in the case of a public offer of shares or debentures. Secondly, there must be established an approved deed in relation to the interest to be offered.

An approved deed is one which is approved by the Registrar of Companies and the appointed trustee or representative of which has received Ministerial approval. The approved deed must further contain a number of covenants binding on the issuer of the interests and the trustee or representative with respect to the proper discharge of their responsibilities and functions.

Meaning of 'Offer to Public'. It is provided that an offer of shares or debentures to a section of the public is generally sufficient to amount to an offer of shares or debentures to the public. Beyond this, there is no definition of what amounts to an offer to the public. It would seem that the question whether a particular group of persons constitutes a section of the public is a question of fact involving the consideration of several factors.

The relationship between the members of the group as well as between the offeror and the members of the group is probably relevant. The size of the group and whether the members are indiscriminately chosen also are likely to be relevant. The question of whether the members of the chosen group require the statutory protection of the prospectus requirement may be a further consideration to be taken into account.

It also is not clear whether the public in this context refers only to the public in Singapore. Presumably, there will be a territorial link requirement in that the offer of shares or debentures is made at least to some persons in Singapore. Once this is satisfied, however, it seems likely that the fact that the offer has been made to other persons abroad will be relevant to determining whether the offer has the quality of being a public as opposed to a private offer.

Listed Securities. In relation to an initial offering of securities for listing, the Stock Exchange of Singapore Ltd requires the offering to be made on a fixed-price basis, or on the basis of a combination of fixed price and tender methods, and generally the issue should be underwritten.

The Stock Exchange of Singapore Ltd should be consulted at an early stage if it is intended to offer securities by other methods or if it is intended to make the issue without underwriting. At least 30 per cent of the public offer is to be allotted to small applicants and, in the event of over-subscription, all applications are subject to balloting.

The Stock Exchange of Singapore Ltd may allow an issue made in connection with a listing on the Main Board to be distributed in whole or in part by way of placing if there is insufficient demand for the securities and it is in the interests of the issuer to permit a placing.

However, a placing will normally not be allowed if there is likely to be significant public demand for the securities, and not more than 25 per cent of any placing may be allocated to discretionary managed portfolios. In addition, unless prior written consent of the Stock Exchange of Singapore Ltd is obtained, no allocations will be permitted to the following persons:

- Directors or existing shareholders of the issuer or their associates;
- Nominee companies, unless the name of the ultimate beneficiary is disclosed; and
- Connected clients of the lead broker or any distributor.

Securities also may be initially listed by way of an introduction that is, an application for listing of securities already in issue where no marketing arrangements are required. This is possible where the securities for which listing is sought are already of such amount and so widely held that their adequate marketability when listed can be assumed. Introductions are appropriate in the following circumstances:

- Where the securities for which listing is sought are already listed on another stock exchange;
- Where the securities of an issuer are distributed in specie by a listed issuer to the shareholders of that listed issuer or to the shareholders of another listed issuer; and
- Where a holding company is formed and its securities are issued in exchange for those of one or more listed issuers.

Generally, the Stock Exchange of Singapore Ltd requires an initial public offering to be made in Singapore to satisfy the demand for such securities in Singapore, but it may agree to a portion of an issue being offered outside Singapore if it considers that the issuer has good reason to do so.

However, no company incorporated in Singapore which is listed with the Stock Exchange of Singapore Ltd will be allowed to be listed on a foreign stock exchange if the foreign stock exchange prohibits companies incorporated in that foreign country from listing their securities with the Stock Exchange of Singapore Ltd, unless such prohibition applies to the listing of the foreign companies on all stock exchanges outside that foreign country.

Disclosure of Acquisition of Substantial Shareholdings

Definition of 'Substantial Shareholdings'. A person who holds a substantial shareholding in a company, ie, a substantial shareholder, is defined as a person who has an interest or interests in voting shares which comprise five per cent or more of the aggregate of the nominal value of the company's voting shares.

In a case where the company has two or more classes of voting shares, a person is a substantial shareholder if he has an interest or interests in voting shares in a class which comprises five per cent or more of the nominal amount of all the voting shares in the class.

There is a wide definition of an interest in shares. A person has an interest in shares, *inter alia*, where:

- He knows, or has reasonable grounds for believing, that he has an interest under a trust which consists of or includes the shares;
- He has a controlling interest in a body corporate which has an interest in the shares, or where such body corporate or its directors are accustomed, or under an obligation to act in accordance with his directions, instructions or wishes;
- He and/or his associates are entitled to exercise or control the exercise of not less than 20 per cent of the votes attached to the voting shares in a body corporate which has an interest in the shares;
- He has entered into a contract to purchase the shares;

- He has a right to have a share transferred to himself or to his order, whether the right is exercisable presently or in the future and whether on fulfilment of a condition or not;
- He has the right to acquire the shares or an interest in the shares under an option, whether the right is exercisable presently or in the future and whether on fulfilment of a condition or not; or
- He is entitled to exercise or control the exercise of a right attached to a share, not being a share of which he is the registered holder.

An interest in a share is not disregarded by reason of its remoteness, the manner in which it arose, or the fact that the exercise of a right conferred by the interest is or is capable of being made subject to restraint or restriction. However, the following, *inter alia*, are not regarded as interests in shares:

- Interests in shares held by a bare trustee;
- Interests in shares held by a person whose ordinary business includes the lending of money if he holds the interests only way of security for the purposes of a transaction entered into in the ordinary course of business in connection with the lending of money; and
- Interests held by a company in its own shares pursuant to a repurchase of shares.

Disclosure Regime Relating to Substantial Shareholdings. There is a statutory regime of disclosure in relation to the acquisition of substantial shareholdings in two types of entities: firstly, a company all or any of the shares of which are listed on a Singapore stock exchange and, secondly, any other entity (regardless of whether incorporated or formed in Singapore) which has been specifically declared by the Minister of Finance to be a company subject to the disclosure regime.

In general, the regime requires that acquisitions of and changes in substantial shareholdings are to be notified to the company or entity concerned and that such company or entity are to maintain a register of substantial shareholders.

These obligations extend to all natural persons, whether resident in Singapore or not and whether citizens of Singapore or not, and to all bodies corporate, whether incorporated or carrying on business in Singapore or not. Furthermore, they apply to acts done or omitted to be done outside Singapore.

Shareholder Duties. A person who becomes a substantial shareholder in a company or entity must give notice in writing to the company or entity concerned stating full particulars of the voting shares in which he has an interest or interests and full particulars of each such interest and of the circumstances by reason of which he has that interest.

Such notice is to be given within two days of his becoming a substantial shareholder. Subsequent notification is required where there is a change in the interest or interests of the substantial shareholder. Such shareholder must, within two days after the date of such

change, give notice in writing to the company or entity concerned stating the full particulars of the change, including the date of the change and the circumstances by reason of which that change occurred.

Written notice also is required to be given where a substantial shareholder ceases to be so. A person who ceases to be a substantial shareholder of a company or entity also must give written notice to the company or entity concerned stating the date on which he ceased to be a substantial shareholder and full particulars of the circumstances by reason of which he ceased to be a substantial shareholder. Such notice is to be given within two days of his ceasing to be a substantial shareholder.

A person who holds voting shares in a company or entity, being voting shares in which a non-resident has an interest, is required to give the non-resident a statutory notice of the requirements of the disclosure regime. In this connection, a non-resident is a person who is not resident in Singapore or a body corporate that is not incorporated in Singapore.

Failure to comply with the above notification requirements constitutes an offence punishable with a fine. It is a defence, however, if such failure is due to ignorance of any fact the existence of which is necessary to constitute the offence, provided that such fact could not have been discovered using reasonable diligence.

Company Duties and Powers. A company or entity to which the disclosure requirements apply must keep a register of the names of its substantial shareholders and the information contained in the relevant notices served by such substantial shareholders. The register must be kept at the registered office or principal place of business and must be kept open for inspection by any person.

A company all of the shares of which are listed on a Singapore stock exchange may by notice require any member to inform the company, within such reasonable time as specified in the notice, whether he holds any voting shares in the company as beneficial owner or as trustee.

If the member holds the voting shares as trustee, the company may require him to indicate so far as he can the persons for whom he holds them and the nature of their interest. The company may then serve a similar notice on such a person requiring him to inform the company whether he holds the interest in the shares as beneficial owner or as trustee. If he holds the interest as trustee, the company may further require him to indicate, so far as he can, the persons for whom he holds it and the nature of their interest.

The company also may, by notice in writing, require a member to inform the company, within such reasonable time as is specified in the notice, whether any of the voting rights carried by any voting shares in the company held by him are the subject of an agreement or arrangement under which another person is entitled to control his exercise of those rights. If there is such an agreement or arrangement, the company may require particulars of the agreement or arrangement and the parties to it.

Failure to comply with any of the above notices served by the company and the making of a false statement in response to a notice are offences punishable with a fine or imprisonment. Failure to comply with a notice is not an offence, however, if it is shown that the

information in question was already in the possession of the company or that the requirement to give it was for any other reason frivolous or vexatious.

Insider Trading and Fraud

Insider Trading Offences. In general, the insider trading offences prohibit dealings in a body corporate's securities by a person if he is in possession of price-sensitive confidential information relating to those securities. In order for such prohibition to apply, such a person must be an insider in that he must be in possession of such information by virtue of his connection with that body corporate or another body corporate which has dealings with that body corporate.

In this context, a person is connected with a body corporate if he is an officer or substantial shareholder of that body corporate or a related body corporate, or he occupies a position that may reasonably be expected to give him access to confidential price-sensitive information by virtue of any professional or business relationship or his being an officer of a substantial shareholder. It also is a general offence for an officer or agent of a company to make improper use of any information acquired by virtue of his position as an officer or agent of the company to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the company.

A person who is not an insider may be prohibited from dealing in a body corporate's securities if he has received price-sensitive confidential information relating to the securities from an insider of the body corporate. This is provided that he was aware or ought reasonably to be aware that the person from whom he received the information was precluded from dealing in the securities and he was associated with that person or had an arrangement with him for the communication of confidential price-sensitive information.

There also are provisions prohibiting a person precluded from dealing in a body corporate's securities from procuring another person to deal in those securities and from communicating the price-sensitive confidential information to another person. In addition, it is an offence for a body corporate to deal in the securities of another body corporate when an officer of the first body corporate is precluded from dealing in those securities.

These offences apply to insider trading in securities issued by any body corporate and not only by companies incorporated under Singapore law or registered foreign companies. Indeed, there is no express requirement that the securities must be issued in Singapore. The term 'securities' includes debentures, shares, stocks or bonds, or any right or option therein or any other participatory business interest issued or proposed to be issued by a government or a body corporate. Furthermore, there is no requirement that the relevant securities must be of a class traded on a Singapore securities exchange or, for that matter, any securities exchange.

However, there is probably a territorial link requirement to be met before the insider trading offences would apply. It would seem that there must be sufficient activity conducted in Singapore which amounts to 'dealing' in the relevant securities for the purposes of the insider trading provisions. In this respect, it is noteworthy that the term 'dealing' is defined widely

to mean, whether as principal or agent, making or offering to make with any person, or inducing or attempting to induce any person to enter into or to offer to enter into:

- Any agreement for or with a view to acquiring, disposing of, subscribing for, or underwriting securities; or
- Any agreement the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the price of securities.

Legislative changes also have been proposed to enable civil proceedings to be commenced without requiring a criminal conviction under the statutory regime.

Market-Rigging Offences. There are several offences dealing with certain market-rigging activities which are regarded as undermining the integrity and proper functioning of the stock market. It is an offence for a person to create a false or misleading appearance of active trading in any securities on a securities exchange in Singapore or a false or misleading appearance with respect to the market for, or the price of, any such securities.

It is to be noted that a Singapore securities exchange must be affected. No offence is committed if a false or misleading appearance is created with respect to a foreign securities exchange, even if the principal acts are committed in Singapore. However, if a false or misleading appearance is created with respect to a Singapore securities exchange, the offence is likely to have been committed notwithstanding that the principal acts are committed outside Singapore.

A further offence stipulates that a person must not effect two or more transactions in securities of a body corporate being transactions that have, or are likely to have, the effect of raising, lowering, or maintaining the price of securities of the body corporate on a securities exchange in Singapore, with intent to induce other persons to deal in the securities of the body corporate or of a related body corporate.

Another similar offence prohibits a person, by means of purchases or sales of any securities of a body corporate that do not involve a change in the beneficial ownership of those securities or by any fictitious transactions or devices, to maintain, inflate, depress, or cause fluctuations in the market price of securities on a Singapore securities exchange. In relation to both offences, the relevant securities (the definition of which is that set out in the preceding section) may be issued by any body corporate and need not be issued by companies incorporated under Singapore law or registered foreign companies.

However, presumably the securities must be of a class listed or traded on a Singapore securities exchange. There is no express requirement that the transactions in question must be performed in Singapore, but it is likely that such a territorial link requirement will be implied.

False and Misleading Statements. It is an offence for a person to make a statement or disseminate information which is false or misleading and is likely to induce the sale or purchase of securities by other persons or to affect or maintain the market price of

securities, if he knew or ought reasonably to have known or did not care that the statement or information was false or misleading.

There is no express requirement that the securities in question be listed or traded on any securities exchange in Singapore or elsewhere, but of course this will often be the case where the false or misleading statement or information is alleged to have affected or maintained the market price of securities. Probably, it must be shown that the act constituting the offence was committed in Singapore, ie, the making of the statement or the dissemination of the information in question took place in Singapore.

However, the likely consequences of inducing the sale or purchase of securities or of affecting or maintaining the market price of securities presumably need not relate to Singapore but may be with respect to sale and purchase transactions or the market price of securities in another jurisdiction.

Other similar offences stipulate that a person must not knowingly or recklessly make or publish any statement, promise, or forecast which is misleading, false, or deceptive, or dishonestly conceal material facts to induce another person to deal in securities.

There appears to be no requirement that the securities in question be listed or traded on any securities exchange in Singapore or elsewhere, and it follows that the securities in question may be unquoted securities or securities which are quoted in a foreign stock exchange. However, presumably the making or publication of the statement, promise, or forecast, or the concealment of material facts, must take place in Singapore.

It also is an offence for a person to circulate or disseminate any statement or information to the effect that the price of any securities of a body corporate will or is likely to rise or fall or be maintained by reason of any transaction entered into or other act done in contravention of the prohibitions relating to market-rigging and the making of false and misleading statements.

This is provided that either such person or his associated party is party to the contravention or he has received or expects to receive some consideration or benefit for circulating or disseminating such statement or information. The territorial link requirement is likely to be met as long as the act of circulation or dissemination of the statement or information is performed within Singapore.

Stock Exchange of Singapore Ltd Requirements. The Stock Exchange of Singapore Ltd Listing Manual contains a Corporate Disclosure Policy which requires listed companies to disclose all information necessary to avoid the establishment of a false market in listed securities.

A listed issuer is required to keep the Stock Exchange of Singapore Ltd and its shareholders informed, as soon as reasonably practicable, of any material information which is necessary to enable them and the public to appraise the position of the listed issuer's group and to avoid the establishment of a false market in the issuer's securities, and which might reasonably be expected to materially affect market activity and the price of the securities.

Occasionally, a listed issuer is permitted to temporarily refrain from publicly disclosing material information, provided that complete confidentiality is maintained. This is usually where immediate disclosure would prejudice the ability of the listed issuer to pursue its corporate objectives, where the facts are in a state of flux and a more appropriate moment for disclosure is imminent, or where the listed issuer is holding negotiations and has not reached an agreement-in-principle.

The Corporate Disclosure Policy also requires any public circulation of information by a party other than the listed issuer which is likely to have an effect on the price of the listed issuer's securities to be clarified or confirmed promptly. If material information has been leaked, a frank and explicit announcement is required while, if the rumours are false or inaccurate, they should be promptly denied or inaccurate. A listed issuer also is required to undertake a review to seek the causes of any unusual trading activity in its securities.

The Stock Exchange of Singapore Ltd has also issued a Best Practices Guide in relation to dealings by a listed issuer's officer in the listed issuer's securities. The Guide states that it is desirable that each listed issuer devise and adopt its own internal compliance code to provide guidance to its officers with regard to dealing by the officers in its securities.

However, an officer should not deal in his company's securities on short-term considerations. Furthermore, he should not deal in his company's securities during the period commencing one month before the announcement of the company's annual or half-year results, as the case may be, and ending on the date of announcement of the relevant results.

Public Take-Over Bids

Regulatory Regime of Take-Overs. Take-overs in Singapore are governed partly by statutory provisions and partly by the Singapore Code on Take-overs and Mergers. The statutory provisions lay down the framework for the conduct of take-overs and authorise the Minister to promulgate the Code which sets down the detailed rules, procedures, and timetables to be observed by the parties involved in a take-over.

Being modelled on the original London City Code on Take-overs and Mergers, the Code is drafted in non-statutory language and is required to be complied with in letter and in spirit. It represents the collective opinion of those professionally concerned in the field of take-overs and mergers on the proper standard of conduct to be observed in a take-over or merger transaction. In addition, there are further rules in the Stock Exchange of Singapore Ltd Listing Manual which companies listed on the Stock Exchange of Singapore Ltd must comply with either when making a take-over offer or becoming a target company in a take-over.

Generally, the regulatory regime does not concern itself with the financial, commercial, and socio-economic merits and demerits of take-overs, and takes the position that this is a question to be decided by the offeree company and its shareholders. Rather, the regulatory regime focuses on the orderly and fair conduct of take-overs and the full provision and disclosure of relevant information and advice. Emphasis also is placed on equal treatment of all shareholders.

The central regulatory body responsible for administering the take-over regulatory regime is the Securities Industry Council, a body established under statute and whose members are made up of representatives from the government, the Monetary Authority of Singapore, and the private sector.

The Council is charged with the task of enforcing the Code and has the power to issue rulings on the interpretation of the Code and the practice to be followed in take-overs. The Council also has limited powers to investigate breaches of the Code and acts of misconduct in relation to take-overs, and may impose sanctions such as public censure. The Council has no formal powers, however, to impose penalties or civil remedies. In practice, the Council works closely with the Monetary Authority of Singapore, the ultimate regulator of the securities industry in Singapore, and the Stock Exchange of Singapore.

In an appropriate case, the Council may recommend to the Authority or the Stock Exchange of Singapore that the facilities of the market should be denied to a delinquent party in a take-over, or that some other appropriate remedial, corrective, or penal measures should be taken. To date, these powers have rarely been exercised and the level of compliance with the Code has generally been high.

Territorial Application. Generally, the regulatory regime applies to take-overs and reverse take-overs of public companies incorporated in Singapore. The statutory provisions expressly apply to the take-over of public companies only. The Code is stated to be drafted with listed public companies in view, but unlisted companies are expected to observe the letter and spirit of the Code wherever possible and appropriate.

Strictly speaking, the regulatory regime does not apply to a take-over of a foreign company, even if the shares of such foreign company are listed on the Stock Exchange of Singapore. However, in such a case, the Securities Industry Council may take the view that the provisions of the Code would have to be complied with. The Council has stated that it will endeavour to grant the protection of the Code in any case where residents of Singapore hold a substantial proportion of the shares or a company incorporated or quoted abroad.

The identity of the offeror is irrelevant to the question of whether the regulatory regime is applicable. The regulatory regime applies regardless of whether the offeror is a natural person or a body incorporate or unincorporate. It also is irrelevant whether the offeror is resident or carrying on business in Singapore or incorporated outside Singapore.

Procedural Requirements. The statutorily prescribed procedure must be complied with once a person has a firm intention to make a take-over offer or where a person triggers the obligation to make a mandatory take-over offer. With respect to the latter, a person is compelled to launch a mandatory take-over offer in two situations.

The first situation is where he, together with persons acting in concert with him, acquires shares carrying 25 per cent or more of the voting rights of a company. The statute also conclusively presumes a person who acquires control of 25 per cent of the voting shares of a company to be conclusively presumed to have a firm intention to make a take-over offer.

The second situation is where a person who, together with persons acting in concert with him, holds not less than 25 per cent but not more than 50 per cent of the voting rights and such person, or any person acting in concert with him, acquires in any period of 12 months additional shares carrying more than three per cent of the voting rights.

The mandatory offer must be in cash or be accompanied by a cash alternative at not less than the highest price paid by the offeror and persons acting in concert with him within the preceding 12 months.

Persons acting in concert comprise individuals or companies who, pursuant to an agreement or understanding (whether formal or informal), co-operate, through the acquisition by any of them of shares in a company to obtain or consolidate control of that company.

The parties which are presumed to be acting in concert are a company with its subsidiaries and associated companies, a company with its directors and their close relatives and related trusts, a company with its pension funds, a fund manager with the fund that he manages on a discretionary basis, and a financial adviser with its clients under certain circumstances.

Once there is a firm intention to make a take-over offer, a public announcement of such firm intention must be made. The board of the offeree company also must inform its shareholders without delay when any firm intention to make an offer is notified to the board from a serious source.

Within 14 days of the public announcement, the offeror must give to the offeree company written notice of the particulars of the terms of the take-over scheme. Within 14 days of the receipt of the written notice, the offeree must give to the offeree a statement containing the recommendation of the offeree's board of directors as to whether the offer should be accepted.

The board must obtain competent independent advice on the offer and the substance of the advice must be made known to the shareholders. The offeror must then send the offer to each shareholder of the offeree company not later than 28 days and not earlier than 14 days after the date of the giving of the written notice. The offer must be accompanied by a copy of the written notice and the recommendation by the offeree's directors.

Alternatively, the offeree company may choose not to give the directors' recommendation to the offeror for despatch by the offeror together with the offer document. The offeree company may instead give each of its shareholders a copy of the directors' recommendation within 14 days after the offers are first made to the shareholders.

An offer must be conditional on the offeror acquiring shares carrying over 50 per cent of the voting rights attributable to the equity share capital of the offeree company. In addition, offers for less than 100 per cent of the equity share capital of an offeree company not already owned by the offeror or any of its subsidiaries are regarded as generally undesirable and the Council's approval must be obtained in advance before such an offer is made.

An offer must initially be open for at least 21 days after its posting. The offer may be revised by increasing the consideration (in which case all shareholders who accepted the original offer must receive the revised consideration) or by extending the period for

acceptance. If there is such a revision, the offer must be kept open for at least 14 days from the date of posting of the written notification of the revision to the shareholders. The maximum period for acceptance is up to 60 days after the offer is initially posted unless the Council grants an extension (usually in the case of a competing offer having arisen).

Once the offeror receives acceptances in respect of more than 50 per cent of the voting rights in the equity share capital of the offeree company, the offer is declared unconditional. The offer may then remain open until further notice, and 14 days' notice must be given before it is closed. Until this 14 days' notice of the closing of the offer has been given, a shareholder who has accepted the offer is entitled to withdraw his acceptance after the expiry of 21 days from the first closing date of the initial offer.

If, however, the offer has not become unconditional by the closing date, the offeror may not make another offer or trigger the obligation to make an mandatory take-over offer within 12 months from the date on which the offer lapses.

Where an offeror, within four months of the making of the take-over offer, secures acceptances from the holders of 90 per cent or more of the nominal value of the shares in the offeree company (other than the shares already held by the offeror or its nominee at the date of the take-over offer), the offeror has, within two months thereafter, the right to compulsorily acquire the remaining shares on the same terms as under the take-over offer.

This is done by the offeror giving notice to the dissenting shareholders and, if no application for relief against the compulsory acquisition is brought by any dissenting shareholder within one month, the offeror may execute an instrument of transfer on behalf of the dissenting shareholders and the offeree company is then obliged to register the offeror as the holder of those shares.

Exemptions. Exemptions from the requirements of the statute may be given by the Minister on a case-by-case basis. The Minister may, by order, exempt a corporation or an individual from compliance with the statutory provisions where, in any particular case, he is satisfied that compliance therewith is inappropriate or would impose an unreasonable burden on the corporation or individual or is not in the public interest.

With regard to the Code, the Securities Industry Council has in some instances the power of dispensation where it is expressly provided, for instance, the waiver of the requirement to launch a mandatory take-over offer. The Council also welcomes the submission of draft documents to the Council in advance to clear unusual features where there is doubt as to whether some aspects of the documents or the proposals contained in them conform to the Code.

Jurisdictional Conflicts

Multilateral Approaches

Substantive Law Solutions

Harmonisation. There have been recent government initiatives to revamp the securities industry regulatory regime to bring it more in line with the regimes of the leading financial

centres of the world. In particular, there seems to be a perceptible shift towards deregulation in a bid to attract foreign investments into Singapore, and active steps have been taken to model disclosure requirements on those of other major financial centres with high disclosure standards.

In 1998, the prominent Corporate Finance Committee ('the Committee') recommended a fundamental shift towards a predominantly disclosure-based philosophy of regulation. The recommendations appear to have been warmly received by the government, although they have not been implemented.

The old merit-based approach, which required the securities regulator to review transactions and decide on their merits, is expected to increasingly give way to disclosure-based regulation and facilitate harmonisation with internationally recognised standards. Of particular interest is that one of the recommendations of the Committee was that Singapore adopt the Disclosure Standards to Facilitate Cross Border Offerings and Listings by Multinational Issuers adopted by the International Organisation of Securities Commission (IOSCO).

Recognition and Enforcement of Foreign Judgments. A foreign judgment may be recognised or enforced in Singapore in two ways: firstly, by bringing a Common Law action based on the foreign judgment (so as to secure a Singapore judgment) and, secondly, by registration of the foreign judgment under the Reciprocal Enforcement of Commonwealth Judgments Act (RECJA) or the Reciprocal Enforcement of Foreign Judgments Act (REFJA).

Common Law Action. Unlike in England, in Singapore, a cause of action is not merged in a foreign judgment. A litigant may choose to restart the legal action but this may be expensive and time-consuming. It is often more convenient to enforce the foreign judgment in Singapore by getting judicial sanction to execute the judgment without a retrial of the merits of the claim.

A foreign judgment does not create a valid cause of action unless it is *res judicata* by the law of the country where it was given. This means that in the court by which the foreign judgment was pronounced, it must conclusively and finally establish the existence of a debt. If it may be altered in later proceedings between the same parties in the same court, it is not enforceable by action in Singapore.

The court giving the judgment also must, according to Singapore's rules of private international law, have international jurisdiction over the parties and full authority to conclude the matter. Furthermore, the foreign judgment must be one on the merits and not based on technical grounds, such as time-bar.

The judgment debtor may, of course, resist recognition or enforcement by pleading that the substantive requirements are not fully established. He also may plead other defences, eg, that the foreign judgment was obtained by fraud, the proceedings in the foreign court were contrary to natural justice, or that the enforcement of the foreign judgment would be contrary to the public policy of the Singapore Court.

Reciprocal Enforcement of Commonwealth Judgments Act. Under the Reciprocal Enforcement of Commonwealth Judgments Act, only foreign judgments from a superior court of the United Kingdom of Great Britain and Northern Ireland and the specified courts of gazetted Commonwealth countries are registrable. Arbitral awards from those countries are registrable if it is enforceable in the foreign country in the same way as a court judgment in that country.

The application for registration under the Reciprocal Enforcement of Commonwealth Judgments Act must be made within 12 months from the date of judgment or such other longer period which the court allows. The court may order the judgment to be registered if it thinks it just and convenient that the courts should enforce the judgment in Singapore.

Once registered, the foreign judgment has the same force and effect as if it had been a judgment originally obtained from the Singapore Court on the date of registration. Costs reasonably incurred in relation to the registration of the judgment are recoverable as if they were sums payable under the judgment.

No one is compelled to rely on the Reciprocal Enforcement of Commonwealth Judgments Act, and it operates alongside the Common Law rules on enforcement. However, if the judgment is registrable, but the plaintiff chooses to enforce the judgment at Common Law, then he must bear the costs of enforcement unless the court otherwise orders.

The judgment must satisfy certain requirements under the RECJA before it may be registered. The judgment may not have been obtained by fraud; it may not offend against principles of Singapore public policy; and the foreign court must have acted within its jurisdiction.

Furthermore, the judgment debtor must have been duly served with the process from the original court, ie, duly served in accordance with the procedural law of the original court unless the procedural law of the original court or its application is shown to be repugnant to the sense of justice of the registering court. There also must be no appeal pending on the judgment.

Reciprocal Enforcement of Foreign Judgments Act. The Reciprocal Enforcement of Foreign Judgments Act only applies to superior courts of foreign countries gazetted under the Act. The Hong Kong Special Administrative Region (SAR) is the first and only jurisdiction thus far gazetted under the Reciprocal Enforcement of Foreign Judgments Act.

The judgment of the superior court should not be given on appeal from a court which is not a superior court, and it must be final and conclusive as between the parties. A judgment is deemed to be final and conclusive notwithstanding that an appeal may be pending against it, or that it may still be subject to appeal, in the courts of the country of the original court. However, a judgment shall not be registered if, at the date of the application, it has been wholly satisfied or it could not be enforced by execution in the country of the original court.

The application to register the foreign judgment should be made to the court within six years after the date of the judgment. A judgment registered under the Reciprocal Enforcement of Foreign Judgments Act shall, for the purposes of execution, the taking of proceedings on the registered judgment, the levying of interest and the control the

registering court shall have over the execution of a registered judgment, be of the same force and effect as a judgment originally given in the registering court and entered on the date of registration.

The registered judgment may be set aside if the registering court is satisfied that the courts of the country of the original court had no jurisdiction or the judgment debtor did not receive notice of those proceedings notwithstanding that process may have been duly served on him in accordance with the law of the country of the original court.

It also may be set aside on the grounds of fraud or that the enforcement of the judgment would be contrary to public policy in the country of the registering court, or that the matter in dispute in the proceedings in the original court had previously to the date of the judgment in the original court been the subject of a final and conclusive judgment by a court having jurisdiction in the matter, or that the rights under the judgment are not vested in the person by whom the application for registration was made.

The Common Law action does not exist in parallel with the Reciprocal Enforcement of Foreign Judgments Act. Unlike the Reciprocal Enforcement of Foreign Judgments

Act, the Common Law action is not available if the Reciprocal Enforcement of Foreign Judgments Act is applicable, except in so far as the Minister directs.

Unilateral Approaches

Antisuit Injunctions

Under Singapore law, it is possible to obtain an antisuit injunction, ie, an injunction which requires a party not to commence or continue proceedings in a foreign court or to discontinue them. The jurisdiction of the court operates *in personam* and, accordingly, the court's injunctive power arises only when the enjoined party is personally subject to the court's jurisdiction.

Antisuit injunctions are not readily granted since, in a sense, they interfere with the jurisdiction of the foreign courts. Furthermore, the court's jurisdiction is to be exercised only when the 'ends of justice' require it. Generally, a Singapore court will restrain a party from pursuing the foreign proceedings only if the pursuit of such foreign proceedings is vexatious or oppressive.

Role of Comity

Comity of nations is a relevant consideration in the grant of discretionary relief by the Singapore courts, and it has been held that the Singapore courts should not assume the role of an 'international busybody'. The effect of comity is most evidently felt as an inhibiting consideration in relation to the grant of antisuit injunctions.

Comity also plays a role in relation to application to stay local proceedings on the ground of *forum non conveniens* so that the dispute may be resolved in a foreign court. Of course, other factors also are taken into account to determine with which jurisdiction the action has the most substantial and real connection, such as the choice of law and the location of the parties and the witnesses.

Spain

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Spain

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Introduction

In General

The master outline of the Spanish stock market is found in Law Number 24/1988 of 28 July 1988 (the 'Stock Market Law', or *Ley del Mercado de Valores*). Following original publication of the Stock Market Law, numerous legal provisions have been introduced to complete the Spanish stock market system.

The Stock Market Law has been thus amended, *inter alia*, by Law Number 37/1998 of 16 November 1998, which implements the European Community (EC) Investment Services Directive, Law Number 44/2002 of 22 November 2000 on the reform of the Financial Market, Law Number 26/2003 of 17 July 2003 on the transparency of listed companies, Law Number 6/2007 of 16 April 2007 on the legal regime applicable to takeover bids, Law Number 47/2007 of 19 December 2007, which implements the provisions of the MiFID Directives in Spain and, more recently, Royal Decree-Law 10/2012 of 23 March 2012 on the amendment of certain rules in relation to the powers of the European Supervisory Authorities, and Royal Decree-Law 24/2012 of 31 August (validated by means of Law 9/2012 of 14 November on restructuration and resolution of credit entities, as amended by Royal Decree-Law 3/2013 of 22 February), which implemented in Spain Directive 2010/73/UE; as well as Law 14/2013 of 27 September on Entrepreneurs; Royal Decree-Law 14/2013 of 29 November, by means of which those measures that needed to be in place as a matter of urgency pursuant to Regulation (EU) Number 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and Directive 2013/36/UE of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms are implemented; and Law 10/2014 on regulation, supervision, and solvency of credit entities.

Law Number 24/1988 amounted to a notable progress in the development of our stock market as pointed out on many occasions by the most prestigious Spanish scholars.[1] It has been stated that 'above all, the Law sets out a comprehensive

1 Sánchez Calero, *Instituciones del Derecho Mercantil* (19th ed, 1996), vol II, at pp 243 *et seq*.

and modern vocation which is translated into a system of rules oriented towards establishing a stock market with internal coherence and which comprises a set of profoundly innovative regulations in comparison to our traditional rules for this market'.[2]

Objectives

The purpose of the Stock Market Law, as provided for in its article 1, is to regulate all matters relating to the Spanish trading systems available to financial instruments, including the establishment of the principles applicable to their organization and functioning, the financial instruments traded in those systems and the issuers thereof, the provision in Spain of investment services, and the supervision, inspection, and sanctioning regime.

Following the implementation in Spain of the MiFID Directives, the Stock Market Law is based on the concept of 'financial instruments', which includes negotiable securities (which basic features are their negotiability and collective issuance) and a wide range of derivative instruments. A key point of the regime set out by the Stock Market Law is the creation of the National Stock Market Commission (*Comisión Nacional del Mercado de Valores*, CMNV), which is a public law organism with its own legal entity. The National Stock Market Commission is a watchdog entity entrusted with the supervision and inspection of the stock market activities, and it has the power to take part in regulatory tasks and to carry forward reforms. It is the Spanish equivalent of the United States' Securities Exchange Commission, the United Kingdom's Financial Services Authority, the Italian CONSOB, and the French *Autorité des marchés financiers*.

Trading System Categories and Proceedings

In General

Pursuant to the Stock Market Law, financial instruments can be traded in regulated markets and multilateral trading facilities.

Regulated Markets

Regulated markets are those which allow the match of sale and purchase orders over financial instruments, give rise to contracts with respect to the instruments traded therein, are authorized to operate on an ongoing basis, and are subject to access, admission to trading, operational procedures, and information and publicity requirements. The existing regulated markets in Spain are:

- Those stock exchanges existing at any given time, with the governing body of each being their operating company;
- The book entries public debt market, with its governing body being the *Central de Anotaciones*, which is administered by the Bank of Spain;

2 Uría, *Derecho Mercantil* (25th ed, 1998), at p 684.

- The futures and options market (MEFF); and
- The fixed rent market (AIAF).

Operation in the regulated markets is governed by each of the markets' regulator. However, in case of transfers of financial instruments traded on a regulated secondary market, it is compulsory that a member entity of the relevant market participates in or mediates the transfer.

The Stock Market Law also establishes the basic principles of the Spanish Clearing and Settlement of Securities Service (IBERCLEAR), which is organized as a limited liability company and, pursuant to the Stock Market Law, carries out clearing and settlement activities in the stock exchanges and the public debt market (although, in practice, it clears and settles in the fixed rent market as well).

Multilateral Trading Facilities

The Stock Market Law defines multilateral trading facilities as systems that allow the match of sale and purchase purposes over financial instruments of multiple third parties in order to give rise to contracts. As distinct from the regulated secondary markets, multilateral trading facilities are to be authorized by the National Stock Market Commission (and not the Ministry of Economy and Competitiveness), can be freely created, and their management company can be an investment firm, a management company of a regulated secondary market (*Sociedad Rectora*), or a special purpose entity incorporated by one or more management companies of regulated secondary markets.

In addition, 'fictitious' markets can be created by investment firms or credit entities by way of the provision of the so-called systematized internalization services (*internalización sistemática*), which consist of the execution by those entities, outside of a regulated secondary market or multilateral trading facilities, and against their own books, of customers' orders in relation to shares admitted to trading in a regulated secondary market, provided that such way of proceeding is maintained on an organized, frequent, and systematic basis and the amount of the orders is equal to or below the standard volume in the relevant market.

Stock Market Regulations

In General

Many development regulations have been enacted to complete the provisions of the Stock Market Law, both by the Spanish Government and the National Stock Market Commission, including:

- Royal Decree Number 726/1989 of 23 June 1989, relating to management companies (*Sociedades Rectoras*) and members of stock exchanges (*Bolsas de Valores*), governing entities (*Sociedad de Bolsas*), and group guarantees (*Fianza Colectiva*);

- Royal Decree Number 1416/1991 of 27 September 1991, covering special securities transactions and the non-exchange transfer of quoted securities and average weighted prices;
- Royal Decree Number 116/1992 of 14 February 1992, regarding the representation of securities by way of accounting entries and the clearance and settlement of securities transactions;
- Royal Decree Number 948/2001 of 3 August 2001, on the investors' guarantee fund;
- Royal Decree Number 1310/2005 of 4 November 2005, on admission of securities to trading in regulated secondary markets, public offers of sale or subscription, and the prospectus required for those purposes;
- Royal Decree Number 1333/2005 of 11 November 2005, on market abuse;
- Royal Decree Number 1066/2007 of 27 July 2007, relating to public offers for the acquisition of securities;
- Royal Decree Number 1362/2007 of 19 October 2007, on the transparency requirements relating to the issuers of securities admitted to trading in a regulated secondary market;
- Royal Decree Number 217/2008 of 15 February 2008, on the legal regime applicable to investment firms and all entities rendering investment services;
- Royal Decree Number 1282/2010 of 15 October 2010, concerning the regulation of the official markets for futures, options, and other derivative financial instruments;
- Royal Decree Number 303/2012 of 3 February 2012, relating to the Consultative Committee of the National Stock Market Commission;
- Royal Decree Number 1082/2012 of 13 July 2012, developing the regime on undertakings for collective investment;
- Royal Decree-Law 24/2012 of 31 August (validated by means of Law 9/2012 of 14 November, on restructuration and resolution of credit entities, as amended by Royal Decree-Law 3/2013 of 22 February), which implemented in Spain Directive 2010/73/UE;
- Royal Decree Number 1698/2012 of 21 December (by means of which Directive 2010/73/UE is implemented in Spain), modifying the previous regulations on prospectuses and transparency requirements of issuers; and
- Circular of the National Stock Exchange Commission Number 3/2013 of 12 June, by means of which certain obligations as to the information that must be provided to clients of investment services for purposes of the suitability and appropriateness test are developed.

National Stock Market Commission

The control, supervision, and inspection of the operation of the Spanish primary and secondary markets and of the activities of those private individuals and legal

entities related to these markets are entrusted to the National Stock Market Commission.

The National Stock Market Commission is a public law organism with its own legal entity and full capacity to act as a private enterprise or a public authority. In the exercise of its public functions, and where the Stock Market Law and any other law is silent on any matter, the National Stock Market Commission will act in accordance with the provisions of Law Number 30/1992 of 26 November 1992 relating to the legal regime of the public administration and the ordinary administrative proceedings.

The National Stock Market Commission is governed by the Stock Market Council, which has those powers granted by the Stock Market Law and those others which may be given by the government or the Ministry of Economy and Competitiveness in accordance with regulations developing the Stock Market Law. The Council is composed of the following members:

- A chairman and vice-chairman appointed by the government on a proposal made by the Ministry of Economy and Competitiveness;
- The General Director of the Treasury and Financial Policy and the Sub-Director of the Bank of Spain, who are *ex officio* members; and
- Three directors appointed by the Ministry of Economy and Competitiveness.

A Secretary with no voting rights must be appointed and must participate in the meetings of the Council. The Executive Committee is composed of the chairman, the vice-chairman, and the directors appointed by the Ministry of Economy and Competitiveness.

The Consultative Committee of the National Stock Market Commission is a body responsible for advising the Council on certain specific matters, including the rules enacted by the National Stock Market Commission and the imposition of sanctions because of very serious infringements. The Committee is chaired by the vice-chairman of the council and includes representatives of the regulated secondary markets, the issuers, the investors, and the Spanish regions (Autonomous Communities) where a regulated secondary market is located. The National Stock Market Commission's functions include:

- Supervise and inspect the stock markets and any activities undertaken by any private individual or legal entity connected with their transactions;
- Register the issuances and public offers relating to traded financial instruments;
- Impose sanctions;
- Provide information to enhance the transparency of the securities markets, ensure adequate price formation, and protect investors;
- Advise the central and, if applicable, the Autonomous Communities on matters connected with the securities markets; and

- Enact rules developing the provisions contained in regulations approved by the government or the Ministry of Economy and Competitiveness. These regulations are known as Circulars.

In addition to the control exercised by the National Stock Market Commission, the Autonomous Communities have the power to control, inspect, and impose sanctions to companies operating within their territories and in relation to securities admitted to trading in markets located in their areas. The National Stock Market Commission may enter into agreements with those regions that are competent in these matters relating to the securities markets for the purpose of coordinating their respective areas.

Legal Regime

Stock Exchanges

In General

There are four stock exchanges in Spain: Madrid, Bilbao, Barcelona, and Valencia. The creation of a stock exchange needs to be authorized by the Ministry of Economy and Competitiveness, unless the Autonomous Community where the stock exchange is located has express statutory power to create an exchange in its region.

The object of the stock exchanges is the trading of securities, although financial instruments traded in other regulated secondary markets can be traded as well in the stock exchanges. Each stock exchange is governed and administered by a limited-liability company known as a management company (*Sociedad Rectora*).

The management company directs and controls the activities undertaken on a stock exchange and, as manager, shall be responsible for the organization of the resources needed to operate the stock exchange. Some of the functions and duties of management companies are to:

- Clearly state and publish the conditions for the admission of securities to trading in the stock exchange;
- Resolve the admission of securities to trading in the stock exchange;
- Ensure that the price formation process is correct and open and that the regulations applicable to transactions are strictly observed;
- Notify the National Stock Market Commission and, where applicable, the corresponding Autonomous Community, of any matter that might amount to a breach of or a deviation from the basic principles of the Spanish stock market legislation;
- Render such assistance to the National Stock Market Commission or to the Autonomous Community as may be requested in connection with the duties of supervision, inspection, and control;

- Request from the National Securities Exchange Commission the suspension of any securities to trading when reporting or other obligations are breached by the issuer or other circumstances which may disturb the normal trading of the securities arise whereby, in urgent circumstances, the management company could unilaterally suspend the trading;
- Propose the exclusion from trading of those securities in relation to which the volume, frequency, or spreading criteria established in the relevant regulations are not fulfilled;
- Ensure that the members of the stock exchanges require clients to give the minimum guarantees and conform to applicable coverage ratios for credit and term transactions; and
- Receive and transmit certain information.

Membership

The following entities can become a member of a stock exchange:

- Investment firms authorized to execute orders on behalf of clients or to operate on their own account (ie, dealers or brokers);
- Credit entities;
- Credit entities or investment firms domiciled in another European Union (EU) member state, provided that they are authorized to execute orders on behalf of clients or to operate on their own account (even on a cross-border basis and without having to hold an establishment in Spain);
- Credit entities or investment firms domiciled outside the EU, provided that their home regulator has authorized them to execute orders on behalf of clients or to operate on their own account;
- The public administration (through the General Directorate of Treasury and Financial Policy); and
- Those other entities as determined by the relevant stock exchange management company in accordance with objective criteria.

It is not necessary that the member entities are shareholders of the management company of the stock exchange.

Stock Exchange Interconnection System

The four Spanish stock exchanges are connected through the Stock Exchange Interconnection System (*Sistema de Interconexión Bursátil* — SIBE), which is a national computer-aided communication system in which listed securities as resolved by the National Stock Market Commission may be traded, provided that they are listed in at least two stock exchanges.

The Stock Exchange Company (*Sociedad de Bolsas*) is a limited liability company in charge of the management of the Stock Exchange Interconnection

System. Its share capital is distributed in equal parts among the four management companies of the existing Spanish stock exchanges, which have an equal representation in the board of directors and appoint an extra member to act as chairman thereof.

Latibex and MAB

Latibex was authorized in 1999 and is an organized system for the trading, clearing, settlement, and registration of transactions over Latin American securities that are expressly admitted for these purposes. It is not a different regulated secondary market with a separate legal entity. The securities admitted to this market are traded in the four stock exchanges.

The main conditions that the securities need to fulfill in order for them to be admitted in Latibex are being admitted to trading in a Latin American official stock exchange, having a capitalization value of at least €300 million, providing evidence of compliance with the applicable obligations in the home stock exchange, and assuring that the information submitted to the home stock exchange is immediately available in the market.

MAB (*Mercado Alternativo Bursátil*) is a system for the trading, clearing, settlement, and registry of shares and other securities in undertakings for collective investment, securities or financial instruments issued or related to entities with a small capitalization, and other securities or financial instruments which, in light of their nature, deserve a singular regime. It is noteworthy that the current regime of MAB is being revised by Spanish authorities and is likely to be amended before the year end in order to enhance supervision and control of the securities that are traded in it and their issuers.

Transactions

The settlement of stock exchange transactions, ie, the completion of agreed sales and purchases, is undertaken by way of multilateral clearing through IBERCLEAR. This service deals with the clearance of all credit and debit balances as between securities and cash amounts that have arisen due to purchase and sale transactions undertaken by each of the entities adhered to the service (*entidades adheridas*) either on their own behalf or on behalf of customers.

IBERCLEAR is a limited-liability company where shareholders are the four stock exchange management companies and the entities adhere to the service. The brokerage firms and agencies that are members of one or more stock exchanges are automatically members of IBERCLEAR. Additionally, the following entities can adhere to IBERCLEAR:

- The credit institutions, the Bank of Spain, and the General Deposits Corporation;
- The *Sociedades* and *Agencias de Valores y Bolsas* (ie, brokers and broker-dealers) which are not members of a stock exchange; and

- The non-resident entities which undertake activities analogous to the *Servicio de Liquidación y Compensación de Valores*, provided that a reciprocity agreement is entered into where the entity is not domiciled in the EU.

Book Entries Public Debt Market

The sole object of the Book Entries Public Debt Market is the trading of fixed rent securities represented through book entries and issued by the State, the Official Credit Entity (ICO) and, at their request, the European Central Bank, EU central banks, development multilateral banks which Spain is a member of, the European Investment Bank, Autonomous Communities or other public entities, as well as other financial instruments as approved from time to time.

The Bank of Spain is the management body of the Book Entries Public Debt Market. The registry of the securities traded in this market has been entrusted to IBERCLEAR, which manages the issuance and redemption of the securities, coupon payments, and balance transfers resulting from transactions in the secondary market. Additionally, IBERCLEAR holds the accounts, which can be individual (in the name and on behalf of the member entities) or global (opened in the name of the member entities but on behalf of their customers). Only those entities complying with the requirements set forth in the Stock Market Law can qualify as members of the Book Entries Public Debt Market.

Futures and Options Markets

In accordance with articles 31 and 59 of the Stock Market Law, the government, pursuant to Royal Decree Number 1282/2010 of 15 October 2010, has developed the regulation for the futures and options markets. In the futures and options markets a wide range of derivative instruments are traded, the underlying being defined by the relevant market management company. The purpose of these markets is the trading, registration, clearing, and settlement of futures, options, and other derivative financial instruments, eligible in accordance with the relevant market regulations.

Futures and options are standardized contracts where the only terms that are subject to negotiation between the parties are price and settlement date. Fulfillment of the agreements is guaranteed by the management company; in other words, each of the parties contracts with the market, so there is no counterparty risk.

Financial futures and options markets need to be authorized by the Ministry of Economy and Competitiveness, except where their scope is regional, in which case they shall be authorized by the relevant Autonomous Community. The options and futures markets currently existing in Spain include MEFF Renta Variable (in Madrid), MEFF Renta Fija (in Barcelona), and Olive Oil Futures Market (in Jaén).

Fixed Rent Market

Enterprise promissory notes, notes, bonds, and other fixed rent securities are traded in the Fixed Rent Market (AIAF). The management company of the market is the Mercado Renta Fija, S.A. Only credit entities, broker-dealers (*sociedades de valores*), or brokers (*agencias de valores*) can become members of this market.

Entities Authorized to Operate in Securities Market

The following types of investment firms exist pursuant to the Stock Market Law:[3]

- Broker-dealers (*sociedades de valores*), which can provide all investment services;
- Brokers (*agencias de valores*), which can only provide investment services on behalf of clients but not dealing for their own account;
- Portfolio management companies (*sociedades gestoras de cartera*), which can only provide portfolio discretionary management and investment advisory services; and
- Financial advisory firms (*empresas de asesoramiento financiero*), which can only provide investment advisory services.

Additionally, credit entities will be entitled to render all investment services, while investment funds management companies can provide specific investment services. EU credit institutions and investment firms are able to provide investment services in Spain (provided that their legal regimes, articles of association, and specific authorizations enable them to do so) by:

- Opening a branch in Spain (subject to a passporting procedure and without a prior authorization being required in Spain); or
- Rendering services on a cross-border basis in the Spanish market (subject to a passporting procedure and without prior authorization being required in Spain).

Non-EU investment firms may provide services in Spain by opening a branch, provided that an administrative authorization from the Ministry of Economy and Competitiveness, on proposal of the National Stock Market Commission, is obtained or by rendering services on a cross-border basis, provided that an administrative authorization from the Ministry of Economy and Competitiveness, on proposal of the National Stock Market Commission, is obtained.

Under the Stock Market Law, the establishment by a Spanish investment firm of a branch or the provision by a Spanish investment firm of investment services

3 Entities whose main activity is rendering investment services over financial instruments to third parties on a professional basis.

abroad will require a mere prior notice to the National Stock Market Commission (if the host country is a EU jurisdiction) or the authorization by the National Stock Market Commission (if the host country is not a EU jurisdiction).

It is the Ministry of Economy and Competitiveness that, on a proposal from the National Stock Market Commission, grants the relevant license so that the investment firms can provide investment services, except in the case of advisory companies, where the National Stock Market Commission is the one that grants the authorization. The requirements necessary to enable an entity to obtain and maintain the above license include:

- Their corporate object must be limited to those investment services which they are able to render according to their authorization;
- Their registered address and main place of business must be located in Spain;
- They must be open limited-liability companies (*sociedades anónimas*) except for the advisory companies, which can be closed limited-liability companies (*sociedades de responsabilidad limitada*) with indefinite duration and share capital divided into registered shares;
- They must have at all times a minimum share capital, fully paid up in cash, whose amount depends on the type of investment firm (it goes from €2,000,000 for securities companies to €50,000 for advisory companies);
- They must have a board of directors of at least three members;
- All members of the board of directors, including the private individuals who represent legal entities which are directors, and all managing directors and similar officers must have a recognized business or professional background;
- The majority of the members of the board of directors and all managing directors and similar officers must have sufficient knowledge and experience in matters related to securities markets;
- They must have an adequate organization, personal means, internal control procedures, and departments and technical support sufficient to deal with the nature and volume of their activities, including without limitation to those necessary to prevent money laundering activities;
- They must have an internal code of conduct and a specific regime for self-dealing by directors, managers, employees, and attorneys;
- Save for certain exceptions, they must fulfill certain ratios of volume of investments in low risk and high liquidity assets;
- They must adhere to the Investment Guarantee Fund (see text, below); and
- They must also comply with the applicable capital requirements as set out in Regulation (EU) Number 575/2013 of 26 June 2013.

Investment firms can appoint agents which can act on their behalf and which can only operate on an exclusive basis for the relevant investment firm and its group. Investment firms remain liable for the performance of their agents. The

following investment services in relation to financial instruments can be provided by investment firms and credit entities pursuant to the Stock Market Law:

- Receive and transmit orders in relation to one or more financial instruments;
- Execute orders on behalf of clients;
- Deal on own account transactions;
- Provide portfolio management;
- Offer investment advice;
- Underwrite financial instruments and/or placing of financial instruments on a firm commitment basis;
- Place financial instruments without a firm commitment basis; and
- Provide multilateral trading facilities management services.

The following ancillary services can be provided by investment firms and credit entities pursuant to the Stock Market Law:

- Offering safekeeping and administration of financial instruments for the account of clients, including custody and related services such as cash/collateral management;
- Granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments;
- Giving advice to undertakings on capital structure, industrial strategy, and related matters and advice and services relating to mergers and the purchase of undertakings;
- Engaging in investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments; and
- Providing services related to underwriting or placement of financial instruments.

The Stock Market Law and Royal Decree Number 948/2001 regulate the creation of the Investors' Guarantee Fund, which is a separate entity with its own legal entity aimed at, under certain circumstances (mainly, insolvency of an investment firm, or express declaration by the National Stock Market Commission in the sense that an investment firm is not able to fulfill its obligations), covering the value of the assets deposited by the investors at the affected firm, up to a certain amount.

All Spanish investment firms other than advisory companies and branches of non-EU investment firms must adhere and contribute to the Investors' Guarantee Fund, while adhesion and contribution by branches of EU investment firms is voluntary. The coverage provided by this fund is complemented with the one granted by the Deposit Guarantee Fund of the credit entities.

Public Offer of Securities, Admission of Securities to Trading, and Prospectuses

Rules on the public offer of securities, and the admission of securities to trading are set forth in articles 25–30 *ter* of the Stock Market Law, Royal Decree Number 1310/2005 of 4 November 2005, and Order Number EHA/3537/2005 of 10 November 2005.

A public offer is defined as a communication to persons by any means or any way which includes sufficient information on the terms of an offer and the offered securities, which allows an investor to decide on the acquisition or subscription of those securities; however, an offer may not be considered in any event as a public offer when:

- It is only addressed to qualified investors (including credit entities, pension funds, investment firms, investment funds, governments, central banks, supranational institutions, and large corporations);
- The number of persons to which it is addressed (excluding the qualified investors) is less than 150 per member state;
- The nominal value per security or the minimum investment in securities is at least €100,000; or
- The aggregate amount of the offer (calculated within the last 12 months if the offer is continuing or made in respect to the same securities more than once) is below €5,000,000.

Any on-sale of securities which has been previously the object of a public offer shall be deemed a separate offer and the same definition of public offer must be used in order to determine whether the public offer regime is applicable to that second offer.

A public offer of securities and the admission of securities to trading in a Spanish regulated secondary market requires compliance with certain requirements, except for certain specific cases set forth in Royal Decree Number 1310/2005 (including exchange of shares, shares offered as part of the price of a takeover bid or in the context of a merger, dividends in shares, and debt securities issued or guaranteed by public bodies). The National Stock Exchange Commission would be the competent authority to supervise a public offer or the admission of securities to trading in these cases:

- For issuances of debt securities with a nominal value of at least €1,000 each and debt securities which entitle the holder to acquire negotiable securities or receive a cash amount as a result of their conversion or the exercise of rights attached to them, when the issuer of the underlying securities is not the issuer of the debt securities or another entity of the same group, if the issuer of the securities is domiciled in Spain, or the securities are to be traded in a Spanish regulated secondary market, or the securities are publicly offered in Spain (and the issuer, offeror, or the applicant selects Spain as home country);

- For securities other than those referred to above, if the issuer of the securities is domiciled in Spain; and
- For securities other than those referred to above, if the issuer of the securities is domiciled outside the EU and the securities are to be traded in a Spanish regulated secondary market, or the securities are publicly offered in Spain (and the issuer, offeror, or the applicant selects Spain as home country).

The documentation to be provided to the National Stock Exchange Commission in the context of a public offer or an application to trade securities in a Spanish regulated secondary market is, in general, the following: (a) the by-laws, (b) the corporate resolutions, (c) audited financial statements of the last three years (for equity securities) or two years (for debt securities) and (d) an informative prospectus which has to be verified and registered with the National Stock Exchange Commission (such verification not meaning any recommendation to buy or an opinion on the solvency of the issuer or the quality of the securities).

The contents of the prospectus are equivalent for public offer and admission to trading purposes (and the same prospectus could be used for both purposes during one year), and are determined by Commission Regulations (EC) 809/2004 of 29 April 2004. As a general principle, a prospectus shall contain all necessary information in relation to the issuer and the securities so that the potential investors may make an informed assessment of the investment.

A prospectus can be a single document or be composed of separate documents: registration document, securities note, and summary. When an updated registration document is already registered with the National Stock Exchange Commission, an issuer can use it and just prepare the securities note and the summary when new securities are going to be admitted to trading. That said, a summary will not be required when the prospectus relates to debt securities for an individual nominal value of at least €100,000.

The summary must be drawn up in a common format (in accordance with the applicable regulations, as provided under Annex XXII to the Commission Delegated Regulation (EU) Number 486/2012 of 30 March), as well as in a brief and non-technical way; reflect the features and essential risks associated to the issuer, the guarantors (if any), and the securities; and contain a statement clarifying that it must be read as an introduction for the prospectus and that a decision to invest will be based on the assessment of the complete prospectus. An investor cannot claim on the basis of the summary, unless it is misleading or inconsistent with the rest of the sections of the prospectus.

A base prospectus can be used for issuances of debt securities or warrants which are issued under an issuance program, or debt securities issued by a credit entity on an ongoing or continuous basis provided that certain conditions are met. A base prospectus contains all information except for the final terms of the securities, which are deposited at the National Stock Exchange Commission afterwards. It is an efficient process as the National Stock Exchange

Commission just verifies and registers the base prospectus, but all issuances made thereunder do not require any further approval.

A supplement of a prospectus (either a base prospectus or an ordinary one) needs to be made when the prospectus contains an inaccuracy or a new significant factor arises in relation to the information contained in the prospectus (for instance, interim financial information) that can influence the assessment of the securities.

There is an obligation to publish all prospectuses and their supplements. Several alternatives are available for these purposes, although in Spain the National Stock Exchange Commission publishes all prospectuses in its website and this requirement is thus automatically fulfilled.

A prospectus verified by and registered with the competent securities market authority of an EU member state can be used for the public offer or admission to trading in other EU member states (without the host member state being entitled to impose any additional requirement). This process, which is called passporting procedure, just involves a notification between supervisors enclosing a certificate evidencing that the prospectus was prepared in accordance with the Prospectus Directive, a copy of such prospectus, and a translation of its summary into the language of the host member state. Additionally, issuers that wish to launch a tender offer or request for the admission to trading of debt securities under a base prospectus previously filed with the competent authorities of the other member states must communicate the final terms to the competent authority of the relevant host member state.

On top of potential criminal and administrative liability, the Stock Market Law and Royal Decree Number 1310/2005 establish a specific liability regime in connection with the prospectus. This liability is imposed on the issuer, offeror, or the person applying for the admission to trade in a regulated secondary market, as the case may be, as well as on its directors, the guarantor (where applicable and in respect of the information prepared by it), the arranger for the information in the securities note in initial public offering, and any other person who accepts to assume liability in connection with the prospectus and that circumstance is reflected therein.

These persons will be liable for the damages caused to those investors that acquire the relevant securities as a consequence of false information included in the prospectus or the omission of significant information therein.

Periodic Returns

Entities which issue securities traded in any secondary market (for these purposes, listed entities) must submit, when Spain is the host member state, certain information on an annual, semi-annual, and quarterly basis to the National Stock Exchange Commission, and shall disclose it on their website. Such information shall be prepared in accordance with Circular of the National Stock Exchange Commission Number 1/2008 of 30 January 2008.

Within four months as from the end of the fiscal year, listed entities must prepare and publish their individual and, if applicable, consolidated annual accounts and management report (which must include a report on corporate governance), as verified by their auditors, together with a statement on their contents signed by its directors.

Within two months as from the end of the first half of the fiscal year, listed entities shall prepare and publish an individual and, if applicable, consolidated summarized balance sheet and interim management report for the first six months, together with a statement signed by their directors on their contents.

Additionally, within two months as from the end of the fiscal year, listed entities must prepare and publish an individual and, if applicable, consolidated summarized balance sheet and management report for the full year, together with a statement signed by its directors on their contents. This obligation may not be applicable if the listed entity has published the annual information referred to above within the first two months.

Within 45 days as from the end of the first and third quarter of the fiscal year, listed entities shall prepare and publish information on the financial position and results of the issuer and its subsidiaries, as well as on significant events (together with its impact on the financial position or results of the group) occurring during the first quarter and the first three quarters, respectively. All transactions of a listed entity with related parties must be disclosed in the semi-annual reports.

Significant Shareholdings

In General

Pursuant to article 53 of the Stock Market Law and Royal Decree Number 1362/2007, those persons who directly or indirectly purchase or transfer shares or financial instruments attributing voting rights in an entity whose shares are listed on a regulated secondary market and, as a consequence, its voting rights reach, exceed, or are reduced to below 3 per cent, 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 40 per cent, 45 per cent, 50 per cent, 60 per cent, 70 per cent, 75 per cent, 80 per cent, or 90 per cent of the voting rights, must inform the issuer and the National Stock Exchange Commission within four stock exchange working days as from the date when the obligor knew or should have become aware that any of the above thresholds have been crossed.

As an exception, where the acquirer or transferor is domiciled in a tax haven or in a territory with no taxation or with which no effective tax information exchange exists, the obligation to report is triggered each time a 1 per cent or any of its multiples are crossed. Additionally, directors of the affected company are obliged to report all purchases and transfers of shares within five stock exchange working days, as well as the shareholding they have when they are appointed and removed, whereas directors and managers must inform of the

stock-options plans and any other plan linked to shares of the listed company (as well as of the operations with shares and derivatives over shares where they or specially-related persons are involved).

In addition to the acquisition or transfer of listed shares, the acquisition or transfer of financial instruments which entitle the holder in its own initiative to acquire existing shares attaching voting rights also trigger the obligation to report. Moreover, even where no acquisition or transfer exists, certain other events would trigger the obligation to report:

- When the proportion of voting rights of a certain person reaches, exceeds, or is reduced below the relevant thresholds as a consequence of a change in the total number of voting rights of the affected company;
- The first listing of a company in a regulated secondary market;
- In the case of a capital increase to be freely allotted by shareholders (*ampliación de capital liberada*), if voting rights are altered because of the purchase or sale of the right to subscribe the new shares; and
- Where a takeover bid is launched, shareholders in the affected company, shareholders with one per cent or more of the voting rights, and shareholders with more than three per cent that modify its shareholding shall make the corresponding notification.

Who Must File

In addition to the direct or indirect shareholders, other persons may have the obligation to report when the voting rights involved reach the thresholds set forth above:

- Regardless of the ownership of the shares, those who acquire, transfer, or have the possibility to exercise voting rights attached to the shares as a consequence of certain transactions set forth in Royal Decree Number 1362/2007, including agreements to syndicate the exercise of the vote in certain circumstances, the temporary transfer of voting rights, and the granting of usufruct rights over the shares;
- The custodian of the shares provided that it can discretionally exercise the voting rights attached to the deposited shares;
- The person who uses an intermediate company or person to hold the shares and voting rights;[4]
- The attorneys, when they can discretionally exercise the voting rights, in absence of specific instructions from the shareholders;
- The undertakings for collective investments management companies in respect of the voting rights attached to the shares held by the undertakings for

4 In particular, in an arrangement where one person leaves the holder of the shares totally or partially covered against the risks inherent to the holding, purchase, or transfer of the shares, the holder of the shares will be an intermediate company and the person assuming the risk would be obliged to report.

collective investments managed by them, except where they expressly waive the exercise of voting rights; and

- Where there is a co-ownership of shares, the person designated to exercise the voting rights.

Notice of Acquisition of Own Shares

The purchase by a listed entity in a single transaction or successive transactions of own shares, either directly or through a controlled or intermediate entity, representing one per cent of the share capital or any of its multiples, must be notified to the National Stock Market Commission.

Significant Information

Listed entities shall disclose significant information (see Rules of Conduct, below) by means of a notice to the National Stock Exchange Commission (*Hecho relevante*) when such significant information may affect the quotation price of the listed company.

Rules of Conduct

In General

Articles 78–83 *quater* of the Stock Market Law, Royal Decree Number 217/2008, and Royal Decree Number 1333/2005 contain the main conduct rules applicable to the securities market, which can be classified into rules of conduct applicable to the rendering of investment services, rules addressing market abuse, and rules concerning a sanctioning regime.

Client Classification

Depending on the type of entity and the experience, knowledge, and qualification in the field of the securities markets, the customers shall be classified as eligible counterparties, professional customers, or retail customers. Those customers classified as retail customers enjoy a higher level of protection under the applicable legislation (for instance, investment firms and credit entities are obliged to furnish the retail customers with extensive information in relation to themselves and the services rendered, the financial instruments and investment strategies, and the platform for the execution of orders and associated costs and expenses).

Inducements

The only fees and benefits permitted under the Stock Market Law and Royal Decree Number 217/2008 are fees and non-cash benefits paid or delivered to entities acting on behalf of the investment firm or the customer; fees and non-cash benefits paid or delivered to third parties or by third parties, provided that certain information on the existence, nature, and amount of those fees or benefits is provided to the customer and payment thereof contributes to an

increase in the quality of the service provided to the customer and does not affect the obligation of the firm to act always in the best interest of the customer; and fees necessary or adequate to properly provide the investment service (such as custody, settlement, currency exchange, or legal fees) and which, because of their nature, cannot conflict with the duty of the firm to act with the necessary honesty, impartiality, diligence, and transparency in the best interest of the customer.

Suitability and Appropriateness

With respect to investment advice and portfolio management services, the investment firm is obliged to obtain as much information from the customer as necessary in relation to its objectives, financial position, risk aversion, experience, and knowledge with the aim of being able to recommend those services and financial instruments which best suit the relevant customer. When it comes to the rest of investment services, the firm must request the information necessary to assess the customer's knowledge and experience and therefore to determine if the product or service requested by the customer is appropriate and warn the customer accordingly.

Best Execution

The investment firms must adopt all reasonable measures to obtain the best possible result for the client's transactions, considering price, other costs, speed, and certainty of the execution, and have a best execution policy in place summarizing the weighted importance of these criteria in the decision on how the orders from customers should be executed.

Insider Trading

Privileged information is any information of a specific nature which directly or indirectly refers to one or more financial instruments or securities or to one or more issuers thereof which has not been made public and which, had it been made public, could have considerably influenced the quotation of such security or securities. Pursuant to article 81 of the Stock Market Law, any person or entity who possesses privileged information (as defined above) may not undertake, whether directly or indirectly, any of the following activities for its own benefit or for the benefit of anyone else:

- Prepare or undertake any kind of transaction in the market relating to the securities or financial instruments to which the information refers, or derivative agreements having those securities or financial instruments as underlying asset;
- Communicate such information to any third party, save in the normal course of work, profession, office, or function; and
- Recommend any third party to acquire or transfer securities or financial instruments or to make any other transaction based on the privileged information.

Disclosure of Significant Information

Under article 82 of the Stock Market Law, significant information is defined as that whose knowledge can affect a reasonable investor in order to acquire or transfer securities or financial instruments and, therefore, can influence significantly their price in secondary regulated markets.

Issuers of securities and financial instruments are obliged to communicate any significant information to the National Securities Exchange Commission prior to the disclosure in any other way, and as soon as the event has been known, the decision has been taken, or the agreement has been executed. Significant information shall also be immediately uploaded to the listed entity's website. The National Securities Exchange Commission can require a listed entity to publicly disclose information that the regulator deems significant.

Exceptionally, the issuer may delay the publication of the significant information when it deems that disclosure would damage its legitimate interests, provided that the non-disclosure does not produce a misleading effect, the issuer can guarantee the confidentiality of that information, and the National Securities Exchange Commission is immediately informed.

The above notwithstanding, there is a broad duty to keep confidential those analysis, preparatory, and negotiation acts prior to the execution of an agreement or taking a decision which may qualify as significant information and, in particular, ongoing negotiations which could be affected if they were disclosed, and resolutions adopted by any corporate body of the listed entity which need to be ratified by another one in order for the decision or agreement to be effective.

During that previous phase, the listed entity shall adopt all necessary measures to ensure confidentiality of that information and, in particular, restrict the access to that information only to those persons as strictly necessary and keep a record of the persons who are aware of the information. If prices or volumes traded in relation to the shares of the listed company become abnormal and there are signs that the confidentiality has been breached, the listed entity shall disclose the significant information.

Distortion of Prices in Market

All persons or entities operating in or related to the securities market must refrain from preparing or carrying out transactions that distort the free formation of prices. For those purposes, operations or orders using fictitious mechanisms or any other way of deception or which provide or may provide false or misleading signs in connection with the offer, the demand or the price of a financial instrument, as well as the spread of misleading information, are considered acts which distort the free formation of prices. Among the activities that are particularly considered as distorting the formation of prices, Royal Decree Number 1333/2005 includes the following:

- The individual or concerted action to retain a dominant position over the offer or demand of a financial instrument with the result of determining non-balanced trading conditions;

- The sale or purchase when the market has closed with the effect of misleading the investors;
- The use of the media to expose an opinion on a financial instrument after taking a position on it and benefiting from the effects of that opinion; and
- Any other specific practices as established by the National Securities Exchange Commission.

Sanctioning Regime

Finally, the Stock Market Law defines a very broad sanctioning regime which extends to all entities or persons that are involved in any way in the securities markets. As aforementioned, the National Securities Exchange Commission is vested with all supervision and inspection powers necessary for the exercise of the sanctioning regime, which include physical inspections and unlimited access to documentation. All information obtained by the National Securities Exchange Commission exercising its functions is subject to a strict secrecy duty that applies to all officials involved.

Takeover Bids

Takeover bids are regulated by articles 60, 60 *bis*, 60 *ter*, 60 *quáter*, and 61 of Stock Market Law and Royal Decree Number 1066/2007 of 27 July 2007, as amended (specifically, pursuant to Royal Decree-Law 4/2004 of 7 March). There are two types of takeover bids, ie, mandatory takeover bids and voluntary takeover bids.

Persons who achieve control of a company listed in Spain are required to launch an offer addressed to all equity securities of the affected company and at a fair price. For these purposes, control is deemed to exist in the following circumstances:

- Through the acquisition of shares and other securities granting, directly or indirectly, voting rights in the listed company in an aggregate percentage of at least 30 per cent. Some rules on computation of voting rights are provided in the applicable regulations (eg, call options over listed shares are not considered for purposes of this threshold until they are exercised);
- Through the designation, within 24 months after the acquisition of shares, of a number of board members which, together with those already appointed by the same person, represent more than half the board; and
- Through an agreement (tacit or express, written or verbal) with other shareholders so that the joint shareholding reaches the 30 per cent threshold, provided that the agreement is aimed at establishing a joint policy in relation to the management of the listed company or at influencing it significantly, or regulates the exercise of the vote in the board of directors or the executive committee.

Additionally, the offeror shall provide a third-party report on the valuation criteria to reach the offer price and offer an alternative cash price if the proposed

consideration is securities, when the target company has been affected in the previous two years by special circumstances (including arguable market manipulation, *force majeure,* or expropriations).

There are cases where, even where control is acquired, the obligation to launch a mandatory takeover bid is not triggered; for instance, in restructuring transactions, or when the control is achieved following the completion of a voluntary takeover bid launched at a fair price or accepted by shareholders representing at least 50 per cent of the shares to which the offer is addressed, excluding those held by the offeror or by those which had a binding commitment to accept. The breach of the obligation to launch a mandatory takeover bid involves a suspension of the exercise of political rights in relation to the shares held by the relevant shareholder.

It is noteworthy that, last March 2014, an amendment to the takeover bids regime in Spain was introduced to clarify that no bid should be launched in those cases where lenders capitalize their debts and convert them into shares of listed companies to the extent that: (a) the relevant company is in serious and imminent financial trouble (even thought it has not yet filed for insolvency) and (b) the transaction is conceived to secure the long-term financial recovery of the company. The National Securities Exchange Commission shall be entitled to decide if those requirements are met on a case-by-case basis, unless the capitalization takes place within the context of a refinancing agreement pursuant to which dissident creditors have been crammed-down.

When a mandatory takeover bid is not required, voluntary takeover bids can be launched, in which case the offer would not have to be at a fair price, may not be addressed to all securities (in certain cases), could include conditions (for instance, the deletion of restrictions in the target company's by-laws or a minimum number of acceptances), and would not have to include an alternative in cash when the consideration consists totally or partially in securities.

Specific sub-types of public offer for acquisition of shares are deemed mandatory takeover bids: the offer for the exclusion of the shares for trading in the Spanish stock exchange, and the public offer for the share capital decrease through the acquisition of treasury stock.

Takeover bids can be totally or partially structured as purchases or exchange of securities, and an equal treatment of all addressed shareholders must be ensured. The offer can include different alternatives at the targeted shareholder's choice, although, if a mandatory offer applies, an alternative in cash is always required.

Fair price is defined in the applicable regulations as follows: (a) where, during the 12 months prior to launching the bid, the offeror or the persons acting in concert with it have acquired shares of the affected company, the fair price cannot be below the highest purchase price during that period; and (b) in any other circumstance, the fair price will not be below that calculated through different methods contemplated in the regulations (including last semester market price track-record and book value). Fair price is subject to supervision

and control by the National Securities Exchange Commission, which shall have the power to modify it in certain cases and request a report on the methodology and criteria used for its determination.

Upon the launch of the offer, the offeror must provide evidence to the National Securities Exchange Commission as to the existence of a sufficient guarantee of the fulfillment of the obligations resulting from the offer, that is, of the payment or delivery of the offer consideration. Such a guarantee shall be different depending on the nature of the consideration (bank guarantees for cash consideration and securities blocking certificates for consideration in securities). The following milestones and features can be highlighted in relation to the takeover proceedings:

- The takeover announcement must be made once the triggering event of the mandatory takeover bid has occurred or the decision to launch a voluntary bid has been taken;
- Within one month as from the announcement, an application for authorization by the National Securities Exchange Commission shall be submitted, including, among the rest of supporting documentation, the takeover prospectus. The trading of the shares of the affected company will be suspended until the National Securities Exchange Commission admits the application;
- The National Securities Exchange Commission must resolve on the application within 20 working days as from the date when all necessary documentation has been filed to its satisfaction;
- The offer must be published within five working days as of the authorization, and at that moment the acceptance period shall be initiated;
- Within the first 10 days after the commencement of the acceptance period, a report must be issued by the board of directors of the affected company, on its position in respect of the offer;
- The offer can be modified through a supplement of the takeover prospectus no later than five days before the expiration of the acceptance period, provided that the modification implies a better treatment for the shareholders (in terms of scope, price, and/or elimination of conditions); and
- Competing offers will be permitted until five days before the expiration of the acceptance period, provided that their scope is at least the same as that of the preceding offer and improves their conditions in terms of scope and/or price.[5]

During all these proceedings, the board of directors and any other management body or attorney of the affected company and other entities within its group shall refrain from carrying out any act which can impede success of the offer, except for looking for competing offers.

5 The first offeror will have certain advantages if the proceedings are to be decided through a closed envelopes procedure.

In particular and without limitation, those under this passivity duty may not resolve any issue of securities, execute or promote operations related to the affected securities, transfer or charge assets of the company, or distribute extraordinary dividends or a special remuneration to the shareholders against the usual policy, where any of these actions can impede the success of the offer.

When, as a consequence of a takeover bid addressed to all the securities, the offeror is owner of securities representing more than 90 per cent of the share capital with right to vote, and more than 90 per cent of the addressed shareholders have accepted the offer, the offeror will be entitled to squeeze out the remaining shareholders at a fair price and the remaining shareholders will be entitled to sell their securities at a fair price. For these purposes, the fair price will be the consideration of the previous takeover bid.

Switzerland

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Switzerland

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Introduction

Regulatory System

Switzerland, as a federal state composed of 26 cantons, has a division of legislative authority between the federal government and the cantons.[1] The federal government is authorised to enact laws only in the areas specifically enumerated in the Constitution.

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1 This report intends to provide an overview on Swiss securities regulations and to outline some aspects that may be relevant for foreign market participants. Therefore, references to details of legal provisions and to specific scholarly opinions are deliberately avoided for ease of reading. Sources consulted in connection with this chapter include: Bauen/Bernet, *Swiss Company limited by Shares* (2007); Bauen/Rouiller, *Swiss Banking, An introduction for bank customers and their advisors. Bank Accounts — Banking Contracts — Banking Secrecy — Private Banking – E-Banking (2013)*; Bizzozero/Robinson, *Financial cross-border activities into and out of Switzerland* (2011); Bohrer, *Corporate Governance and Capital Market Transactions in Switzerland* (2005); Bohrer/Kubli, *Mandatory Offer or Opting-out? Guidelines for Companies listed on a Swiss Exchange*, in ST 72 (1998); Bovey/Peter, *Swiss Takeover Board: new and evolving issues*, in SZW (2011); Bühler, *Regulating Corporate Governance following the „Swiss Muesli" Recipe*, in SZW (2013); Daeniker, S*wiss Securities Regulation, An Introduction to the Regulation of the Swiss Financial Market* (1998); Du Pasquier/Fischer, *Cross-border financial services in and from Switzerland – Regulatory frameworks and practical considerations*, in GesKR (2010); Gnos/Hänni, *Acquisitions on the verge of Swiss takeover rules*, in GesKR (2011); Iffland, *Recent developments in securities regulation*, in SZW 71 (1999); Mettier/Zobl, *Switzerland's Stock Exchange Law* (1998); Nobel, *Swiss Finance Law and International Standards* (2002/latest update: 2006); Rehm/Sigismondi, *Ad hoc-Publizität aus Emittentensicht*, in GesKR (2012); Röthlisberger, *Disclosure of interests in shares: a comparative analysis United Kingdom – Switzerland* (1998); Röthlisberger/Nägeli, *Defending against a hostile bid: a defence support manual for SWX Swiss Exchange listed companies* (2004); Ryser/Weber, *Bekanntgabeaufschub gemäss Art. 54 KR*, in SZW 84 (2012); Ryser/Weber, *Hedging durch Spitzenkräfte aus börsen- und aktienrechtlicher Sicht,* in GesKR (2010); Weber, *Securities Structuring of a Modern Capital Market: The Swiss Example*, in Goo/Arner/Zhou (ed), *International Financial Sector Reform: Standard Setting and Infrastructure Development* (2002). English versions of the governing laws and regulations can be found on the SIX Swiss Exchange Regulation's website: http://www.six-exchange-regulation.com /index_en.html and on the website of the Swiss

Capital markets and securities laws fall under the federal legislative authority.[2] In the past, as long as the federal government had not exercised such authority, the cantons were free to regulate stock exchanges; therefore, until 1996, several stock exchanges existed in different cantons. Since then, the main stock exchange activities have been combined, at first, in a civil law association and, subsequently, in a joint-stock company, SIX Swiss Exchange Ltd (formerly SWX Swiss Exchange Ltd), which conducts the SIX Swiss Exchange (formerly SWX Swiss Exchange), in Zurich. SIX Swiss Exchange Ltd is a subsidiary of SIX Group Ltd (formerly SWX Holding Ltd), which holds other subsidiaries such as SIX x-clear Ltd and SIX SIS Ltd, through which clearing and settlement of securities transactions as well as central securities depository services are provided. SIX Group Ltd also holds participations in international joint ventures, such as Scoach and STOXX. Another, less important stock exchange in Switzerland is the BX Berne eXchange in Berne.

The Swiss regulatory system is based on two pillars, namely, on the laws and ordinances of the formal legislator, constituting the legal framework, on the one hand, and on the self-regulation of private organisations, on the other hand. The second pillar is of major importance, particularly to the stock exchanges, which are required to ensure that their operations, administration, and supervision are organised in a manner that is adequate for their business activities.

Legal Sources

Stock Exchanges

The main legal source in the field of securities regulation is the Federal Act on Stock Exchanges and Securities Trading (Stock Exchange Act) of 24 March 1995, as amended. It was brought into force in two steps on 1 February 1997 and 1 January 1998. The Stock Exchange Act constitutes the legal basis for the enactment of several ordinances and reflects three principles, namely:

- The replacement of the previous cantonal stock exchange laws;
- The establishment of the first fully electronic stock exchange in the world; and
- The most important move from a mainly organisational to a more transactional regulatory regime.

Consequently, the rules of the Stock Exchange Act are not only designed to govern and protect the players in the capital market (i.e., stock exchanges, securities dealers, issuers, and investors), but they also take into account the functions of the financial markets in the economy.

In general, the Stock Exchange Act contains provisions with regard to the admission and organisation of stock exchanges, the admission and organisation of

Takeover Board: see http://www.takeover.ch/. Information on legal and regulatory developments with particular focus on Swiss capital markets is further provided by the electronic newsletter journal CapLaw: www.caplaw.ch.

2 Swiss Federal Constitution, art 98.

securities dealers, the disclosure of acquired or sold important participations in companies listed in Switzerland, and the takeover of listed companies.

The Stock Exchange Act only regulates transactions on the secondary market; after some consideration, the legislator decided that the primary market should be left to the rules of the Swiss Federal Code of Obligations (Code of Obligations); nevertheless, it must be noted that these rules are much less transaction-oriented, and they do not provide for the same degree of transparency as the provisions of the Stock Exchange Act.

An extension of the legislation, however, does not seem to be likely in the near future. The legal framework for the operation of a securities exchange and for trading in securities can be shown as follows (source: SIX Swiss Exchange):

The most important ordinances and regulations enacted on the basis of the Stock Exchange Act are:

- The Ordinance on Stock Exchanges and Securities Trading (Stock Exchange Ordinance);
- The Ordinance of the Swiss Financial Market Supervisory Authority (FINMA) on Stock Exchanges and Securities Trading (Stock Exchange Ordinance-FINMA);
- The Ordinance of the Takeover Board on Public Takeover Offers (Takeover Ordinance);
- The Regulations of the Takeover Board; and

- Several Circulars (*Rundschreiben*) of FINMA and of the Federal Banking Commission (one of FINMA's predecessors virtually all are taken up by FINMA Circulars).[3]

Based on its self-regulating competence, the SIX Swiss Exchange enacted a number of other self-regulating rules and directives. The most important rules and directives are:

- The Articles of Association of the SIX Swiss Exchange;
- The Rules of Organisation of the SIX Swiss Exchange;
- The Rule Book of the SIX Swiss Exchange;
- The Listing Rules of the SIX Swiss Exchange (Listing Rules);
- The Additional Rules for the Listing of Bonds;
- The Additional Rules for the Listing of Derivatives;
- The Additional Rules for the Listing on Exchange Traded Products;
- The Rules of Procedure of the SIX Swiss Exchange;
- The SIX Swiss Exchange Rules for the Appeals Board (Appeals Board Rules); and
- Several directives, prospectus schemes, and circulars governing the admission of participants, the trading of securities on the SIX, and reporting and disclosure requirements.

Moreover, the legal framework for clearing and settlement of securities transactions as well as for the central securities depository comprises, besides provisions of private law as well as the technical regulations of each system, the Federal Intermediated Securities Act (FISA). FISA came into force on 1 January 2010 and introduced a new category of assets called "intermediated securities" (*Bucheffekten*), thereby putting electronic book-entry changes which obviate the need for physical movement of securities — a practice which was already successfully used in Switzerland — on a more solid legal footing.

Investment Funds

The Federal Act on Collective Investment Schemes (the 'Collective Investment Schemes Act'), enacted in 2006, regulates the admission, promotion, and activities of Swiss collective investment schemes (i.e., funds whose management is domiciled in Switzerland).

The scope of the Collective Investment Schemes Act covers all forms of collective investments irrespective of their legal status and structure, including collective investment schemes in corporate form (investment companies with variable capital (SICAVs), investment companies with fixed capital (SICAFs), and limited partnerships for collective investments.

3 See http://www.finma.ch/e/regulierung/pages/rundschreiben.aspx.

Moreover, foreign collective investment schemes organised in whatever form (including corporation) under their respective legislation and which are distributed publicly in or from Switzerland also fall within the scope of the Collective Investment Schemes Act and may be authorised to distribute their certificates in Switzerland.

The Collective Investment Schemes Act has recently been revised in order to bring it into line with European Union regulations. Following the revision, which came into force on 1 March 2013, a binding subjection obligation under the Collective Investment Schemes Act for the asset managers of foreign collective investment schemes was introduced;[4] as regards foreign collective investment schemes distributed in or from Switzerland solely to "qualified investors", which were hitherto unregulated, these have now to meet certain conditions, including the appointment of a FINMA licensed representative in Switzerland.[5]

Other Market Participants

The status of the major market participants (apart from the securities dealers) is governed by specific laws. Banking activities are subject to regulations of the Swiss Federal Act on Banks and Savings Institutions of 1934 (Banking Act), as amended, the primary purpose of the Act being to protect depositors, the secondary purpose being the protection of the banking system as such.

Private insurance business in Switzerland is regulated by the Federal Act on the Supervision of Insurance Companies of 2004, as amended, the purpose of the Act being to protect insured persons.

Authorities

The Swiss securities markets and the Swiss banking markets are supervised by FINMA. FINMA has a management structure with a Board of Directors and an Executive Board. The Board of Directors of FINMA is composed of seven to nine members, all experts in the relevant subjects and independent from the market participants. FINMA is staffed with approximately 350 qualified professionals; formally, FINMA is constituted as an independent regulatory agency (*öffentlich-rechtliche Anstalt*), and it is not part of the general administration of the government.

The SIX Swiss Exchange is incorporated as a joint stock company in accordance with articles 620 *et seq.* of the Code of Obligations; its management and supervision structure follows general company law rules. The shareholders of its holding company, SIX Group Ltd, are banks and securities dealers. A special supervisory authority, the 'Disclosure Office', dealing with the reporting obligations under the rules on disclosure of shareholdings, has been established.[6]

4 Collective Investment Schemes Act, art 2, al 1.
5 Collective Investment Schemes Act, art 120, al 4, and 123, al 1.
6 Stock Exchange Act, art 20, al 5; Stock Exchange Ordinance-FINMA, art 25; Rules for the Disclosure Office.

The tender offer rules are supervised by another special supervisory authority, the Takeover Board;[7] the Takeover Board has the task and function to examine, in each case, whether the concerned offeror or other relevant market participants are acting in compliance with the applicable regulations.

The Takeover Board is composed of (part-time) experts active in the capital market field. It enacts in the form of legally binding decisions, which can be challenged before FINMA. Furthermore, the offering prospectus of the offeror must be examined prior to its publication by a special auditor approved by FINMA or a securities dealer.[8]

Procedures

The procedural framework depends on the matter and the authority involved. The procedures for actions before the Takeover Board are with a few exceptions governed by the applicable procedural rules of the Federal Act on Administrative Procedure.[9]

Decisions by the Takeover Board can be challenged before FINMA within five trading days. Decisions by FINMA can be appealed to the Swiss Federal Administrative Court.[10] A further appeal to the Swiss Federal Supreme Court is, subject to certain limited exceptions, no longer possible.[11] Thus, the decision by the Federal Administrative Court is final.

The SIX Swiss Exchange and its regulatory bodies apply their own rules (Rules of Procedure; Appeals Board Rules); in the case of the Appeals Board, if there are no applicable special rules, the Federal Act on Administrative Procedure will be applied analogously.[12]

Disputes with the SIX Swiss Exchange and its regulatory bodies, in particular those concerning sanctions that have been imposed by the Swiss Exchange Regulation, are decided solely and finally by the Board of Arbitration based in Zurich, and only once internal remedies available at the SIX Swiss Exchange (Sanction Commission, Appeals Board) have been exhausted.[13]

Legal Order and Regulatory Interests

Admission

Market Participants

In General. The main participants in the capital market activities are the stock exchanges and the securities dealers; a good number of securities dealers are

7 Stock Exchange Act, art 23; Takeover Ordinance; Regulations of the Takeover Board.
8 Stock Exchange Act, art 25.
9 Stock Exchange Act, art 33b, al 1.
10 Stock Exchange Act, arts 33c, al 1, and 33d.
11 Cf. Swiss Federal Supreme Court Act, art 83 (u), which states that decisions in takeover matters cannot be challenged by way of appeal in matters of public law before the Federal Supreme Court.
12 Appeals Board Rules, art 5, al 2.
13 Rule Book, art 24, al 2.

already licensed and admitted as banks; in such case, the banking licence is automatically extended to the securities business.

Domestic Exchanges. The operation of a stock exchange is subject to an authorisation by FINMA.[14] The authorisation is granted to legal entities that fulfil the legal requirements and undertake to ensure an appropriate organisation with respect to their activity.

The SIX Swiss Exchange in Zurich and the BX Berne eXchange have been granted a licence to operate a stock exchange under the Stock Exchange Act. The BX Berne eXchange is an electronic stock exchange on which some 40 mostly mid-size or real estate companies are currently listed. Legal entities controlled by foreign persons or organised under foreign law may be admitted to operate a stock exchange in Switzerland, provided that the principle of reciprocity is respected.[15]

Organisation. The organisation of the stock exchanges is governed by the principle of self-regulation as stated in article 4 of the Stock Exchange Act. The respective provisions (e.g., organisational rules and listing requirements) have been enacted by the SIX Swiss Exchange (see text, above).

Functions. The SIX Swiss Exchange has issued regulations regarding the admission, duties, and exclusion of securities dealers; according to article 7 of the Stock Exchange Act, these regulations must reflect the principle of equal treatment of the market participants.

Before admitting foreign securities dealers, the SIX Swiss Exchange must inform FINMA. Since Switzerland ratified the Fifth Protocol to the General Agreement on Trade in Services (GATS) in 1998, the admission of foreign securities dealers has been simplified (see text, below).

The SIX Swiss Exchange has established an internal supervisory and controlling body for complaints raised by securities dealers.[16] The SIX Swiss Exchange issued regulations on the listing of securities (the Listing Rules) that contain provisions relating to:[17]

- The admission and trading of securities;
- The information to be provided by the listed companies to the investors; and
- The internationally recognised accounting standards that must be complied with by the listed companies.

These Listing Rules have been amended several times, particularly in 2000 and 2009, to harmonise them with the prevailing European standards. The current version dates from November 2010. There are additional listing rules with respect

14 Stock Exchange Act, art 3.
15 Stock Exchange Act, art 37.
16 Stock Exchange Act, art 9.
17 Stock Exchange Act, art 8.

to the listing of bonds, the listing of derivatives, and the listing of exchange traded products.

The SIX Swiss Exchange also has issued regulations that are designed to organise the market to achieve efficiency and transparency. Furthermore, the very detailed rules of FINMA on the disclosure of acquisition or sale of important participations (disclosure of shareholdings) are particularly noteworthy.

Supervision. An internal supervisory and controlling body, composed of experts in financial market matters, has been established to allow the market participants to file a complaint against actions and decisions rendered by the management of the SIX Swiss Exchange. The final supervision lies with FINMA, with the possibility to appeal certain decisions at the Swiss Federal Supreme Court.

Transnational Electronic Trading Systems. The SIX Swiss Exchange has entered into transnational trading system co-operations, each with its own regulations. SCOACH is a joint venture by the SIX Swiss Exchange and Deutsche Börse AG for the trading of structured products. SIX Swiss Exchange, however, exited another such transnational trading system when in 2011 it sold its stake in the EUREX derivatives exchange to its joint venture partner, Deutsche Börse AG.

Trading in Other "Goods". Other "goods" not normally associated with capital markets are also amenable to being traded on an exchange or other established marketplace. One such example is the electronic platform called "Swiss-Flex" for trading carbon dioxide emission credits, which was created under the purview of the Federal Office for the Environment. Moreover, regarding the relatively new field of power derivatives, these are mostly traded on exchanges domiciled outside of Switzerland (such as EEX) which, pursuant to the Stock Exchange Ordinance, fall under the scope of FINMA in as much as they provide securities dealers in Switzerland access to their facilities.[18]

Furthermore, the Stock Exchange Act specifically empowers the Federal Council to set up rules concerning the trading of electricity on a stock exchange.[19]

Off-Market Transactions. Swiss law does not specifically regulate off-market transactions. However, it must be borne in mind that the Stock Exchange Act states certain minimum levels as to the purchase price of securities within a compulsory takeover action for the acquisition of the outstanding securities.

In particular, the price offered must be at least as high as the stock exchange price and may not be lower than the highest price paid by the offeror for shares of the target company in the preceding 12 months.[20] Therefore, the off-market purchases of shares prior to a takeover bid should not be made at prices that do not reflect the market situation.

18 Stock Exchange Ordinance, art 14.
19 Stock Exchange Act, art 2a.
20 Stock Exchange Act, art 32, al 4.

Banks and Securities Dealers. By legal definition, the business of a bank consists of accepting deposits from the public and extending loans on its own account and risk to third parties/entities to earn its income from the spread between the interest paid to the depositors and the interest received by the debtors.

Irrespective of the fact that banks have been pursuing activities in many other areas of the financial sector (i.e., asset management, private equity, and investment banking) for a long time, no separation has existed under Swiss law between the commercial banking and the investment banking business. Consequently, as outlined above, most securities dealers in Switzerland are banks. Banking activity is subject to authorisation and supervision by FINMA. The licence is granted if the conditions set forth in the Banking Act are met, in particular:

- Organisational requirements — Swiss banks must have a place of business in Switzerland, a fully paid-in capital of at least CHF 10 million, a clearly defined scope of business in the articles of incorporation and, in the by-laws, an adequate internal organisation, appropriate risk management procedures, and an effective internal control system (internal inspectorate).[21]
- Directors, managers, and qualifying shareholders — The Banking Act explicitly requires that the directors and the managing officers of a Swiss bank must have a good reputation and offer assurance of a proper business conduct.[22] When interpreting the term 'proper business conduct', FINMA exercises a high degree of discretion. Likewise, so-called qualifying shareholders of a bank holding 10 per cent or more of the capital or the voting rights also are (similar to the regulations of the European Union) subject to the test of 'proper business conduct'. The Banking Act relies on the principle of strict separation between the management and the board of directors, thus aiming at a supervision of the management within the corporate organisation.
- Particularities for banks controlled by foreign shareholders — A bank domiciled in Switzerland is considered to be under foreign control if one or more foreigners directly or indirectly hold qualifying shareholdings exceeding 50 per cent of the voting rights or if foreigners exercise a controlling influence on the bank otherwise.[23] The Banking Act makes it clear that a foreign bank incorporating a subsidiary in Switzerland needs to be aware of the fact that such subsidiary is subject to the Swiss banking supervisory rules. In particular, the licence will be granted to a foreign-controlled subsidiary if the home country of the foreign bank grants reciprocal treatment to Swiss banks establishing banking operations under its jurisdiction, the foreign-controlled bank is not choosing a corporate name suggesting that the bank is controlled by Swiss persons, the foreign-controlled bank is complying with the information rules of the Swiss National Bank and, in the case of a financial conglomerate, an adequate supervision on a consolidated basis is ensured. Special rules apply if a

21 Banking Act, art 3, al 2.
22 Banking Act, art 3, al 2 (c).
23 Banking Act, art 3*bis*, al 3.

foreign bank envisages to establish a branch or a representative office in Switzerland. In particular, FINMA will look at the supervision of such bank in its home country and the existence of reasonable internal rules defining the organisation and the scope of business of the entity in Switzerland. It also is important to note that the Banking Act, with regard to international consolidated supervision, now allows foreign supervision agencies to operate controls *in loco* over Swiss subsidiaries of foreign banks that are subject to their jurisdiction. The Banking Act also allows foreign-controlled banks in Switzerland to make data available to the foreign parent company without violating Swiss banking secrecy rules, to the extent that such disclosure is strictly necessary for the purposes of a consolidated supervision.

- Financial Soundness Rules/Accounting and Auditing — Swiss banks must provide for an adequate proportion between their equity and their total liabilities and their liquid assets and easily marketable assets and their short-term liabilities. In this respect, the Banking Ordinance and the Capital Adequacy Ordinance provide for detailed capital adequacy requirements which are mainly the result of negotiations within the Basle Committee on Banking Supervision, as well as for detailed accounting and consolidation rules that apply in addition to the accounting and consolidation rules set forth under Swiss corporate law. The new international rules on bank capital — known as Basel III — have been adopted into the Capital Adequacy Ordinance (and accompanying FINMA circulars) and entered into force on 1 January 2013 with transitional deadlines in line with the international framework. Moreover, enhanced capital, liquidity, and organisational requirements applicable to systemically important banks have been introduced.[24] The financial statements of a bank are subject to specific reviews by qualified auditors who are requested by law to assist FINMA in its supervisory activity. Therefore, the auditors' reports for banks are generally much more detailed than those for other corporations. However, this system may lead to potential conflicts of interest, the auditors having a duty of faithful and careful performance of the auditing mandate towards their client. Effective as of 1 September 2012, FINMA's competencies which concern the supervision of financial audits of listed banks have shifted to the Federal Audit Oversight Authority.

The ordinance to the Stock Exchange Act defines categories of securities dealers, namely:

- Underwriters (making primary offerings of securities to the public on a professional basis);
- Derivative houses (creating and offering derivatives to the public on a professional basis); and
- Broker-dealers, constituting three sub-categories, these being dealers trading on their own account, market makers, and brokers buying and selling in their own name but for the account of third parties.

24 Banking Act, arts 7 *et seq*.

To achieve an equal treatment among the market participants, the requirements for obtaining the securities dealer licence are similar to those for obtaining a banking licence. However, the law provides for some differences. The minimum capital requirement of securities dealers amounts to CHF 1.5 million (instead of CHF 10 million for banks).

Furthermore, securities dealers must observe the rules of conduct issued by the Swiss Banker's Association with regard to the duties of information, of due diligence, and of loyalty towards the customer. Even though the Stock Exchange Act does not specifically require strict separation between the board of directors and management, FINMA has established a practice making this separation necessary, unless the organisation is so small that a separation is not feasible.

Securities

Listing Rules and Additional Rules. The admission of securities to the trading on the SIX Swiss Exchange is governed by the Listing Rules of the SIX Swiss Exchange and its supplementary provisions. There are additional listing rules with respect to the listing of bonds, the listing of derivatives, and the listing of exchange-traded products.

In addition, there are specific rules concerning the admission of equity securities to trading in the SIX Swiss Exchange-Sponsored Segment, the admission of international bonds to trading on the SIX Swiss Exchange, and for the trading in delisted bonds on the SIX Swiss Exchange.

Regulatory Standards. On the SIX Swiss Exchange, the following regulatory standards can be distinguished (source: SIX Exchange Regulation):

Main Standard. The Main Standard is used for listing of equity securities. The respective listing requirements are set out in the Listing Rules and the Additional Rules. Foremost among these are requirements regarding the size and liquidity of issuers and stringent transparency requirements with which issuers must comply.

Domestic Standard. The Domestic Standard serves as a means for listing equity securities of companies that — due to their investor base, corporate history, capitalisation, or equity securities distribution — do not, or do not yet, qualify for listing according to another standard. In particular, this standard accommodates companies with local significance or a limited circle of investors, such as family-owned enterprises and certain international companies.[25]

Standard for Investment Companies. Equity securities issued by investment companies are listed according to their own regulatory standard. Investment companies are joint-stock companies whose main purpose is the investment in collective investment schemes and thus earning yields and/or capital gains. They

25 Admission to the Domestic Standard is governed by articles 85 *et seq*. of the Listing Rules.

do not perform a commercial activity in the literal sense. Such companies can be compared with investment funds in regards to their investment strategy, but they are organised under company law.[26]

Standard for Real Estate Companies. Real estate companies are governed by their own regulatory standard. A company qualifies as a real estate company if it continually draws at least two-thirds of its revenue from real estate-related activities, specifically from rental income, income from revaluations or sales, and from real estate services.[27]

Standard for Collective Investment Schemes. The listing of units (or shares) of domestic or foreign collective investment schemes that, pursuant to the Federal Act on Collective Investment Schemes (CISA), are subject to the supervision of FINMA is governed by articles 105 *et seq*. Listing Rules.

Standard for Global Depository Receipts. The standard for global depository receipts serves as a means for listing global depository receipts ("GDRs"). GDRs are tradable certificates which are issued in lieu of deposited equity securities and enable the (indirect) exercise of the membership and proprietary rights attached to such deposited equity securities (the "underlying equities").[28]

Standard for Bonds. Bonds (including conversion and warrant bonds) are listed in accordance with the Standard for Bonds.[29] In conjunction with the listing of bonds, the issuer has the option to make use of the procedure for provisional admission.

Standard for Derivatives. The Derivatives Standard serves as a means for listing derivatives.[30] Generally speaking, derivatives are financial instruments, the value of which is based on the price of the underlying securities or reference rates. Similar to bonds, derivatives may first be provisionally admitted to trading before being listed and the respective applications are submitted via Internet Based Listing ("IBL").

Standard for Exchange Traded Products. The Standard for Exchange Traded Products serves the listing of collateralised, non-interest-paying bearer debt securities (debentures), which are issued as securities and are sold and redeemed in the same structure and denominations on a continuous basis.[31] In addition, Exchange Traded Products replicate the price trend of an underlying instrument, either unchanged or leveraged (tracker certificate).

Admission and Maintenance Criteria. Depending on the regulatory standard, differing criteria with regard to admission and maintenance of listing must be

26 Listing Rules, arts 65 *et seq*.
27 Listing Rules, arts 77 *et seq*.
28 Listing Rules, arts 90 *et seq*.
29 Additional Rules Bonds.
30 Additional Rules Derivatives.
31 Additional Rules Exchange Traded Products and Additional Rules Derivatives.

observed. The following charts give an overview on the main criteria (source: SIX Exchange Regulation):

Equity Securities.

			Main Standard	Domestic Standard	Standard for Investment Companies	Standard for Real Estate Companies	Standard for Depository Receipts
Track Record	•		3 years	2 years	n.a.	n.a.	3 years
Minimum Capital Requirements	•		25 m	2.5 m	25 m	25 m	25 m
Free Float in %	•		25%	20%	25%	25%	25%
Free Float Market Capitalisation	•		25 m	5 m	25 m	25 m	25 m
Financial Reporting	•	•	IFRS/US-GAAP	FER/IFRS/US-GAAP	IFRS/US-GAAP	FER/IFRS	IFRS/US-GAAP
Regular Reporting Obligations		•	Yes	Yes	Yes	Yes	Yes
Ad hoc Publicity		•	Yes	Yes	Yes	Yes	Yes
Corporate Governance		•	Yes	Yes	Yes	Yes	No
Management Transactions		•	Yes	Yes	Yes	Yes	No
List of Insiders		•	No	No	No	No	No

■ Listing
■ Being Public

Collective Investment Schemes, Debt Securities and Exchange Traded Products.

			Standard for Collective Investment Schemes (ETFs)	Standard for Bonds	Standard for Derivatives	Standard for Exchange Traded Products (ETPs)
Track Record	•		n.a.	3 years	3 years	3 years (1)
Minimum Capital Requirements	•		Fund assets to the value of 100 m	25 m	25 m	25 m (1)
Minimum Capitalisation of the Issue	•		–	20 m	1 m	1 m
Free Float in %	•		25% or market-maker agreement	–	–	–
Free Float Market Capitalisation	•		25 m	–	–	–
Financial Reporting	•	•	Special legal provisions	IFRS/US-GAAP	IFRS/US-GAAP	IFRS/US-GAAP (2)
Regular Reporting Obligations		•	Yes	Yes	Yes	Yes
Ad hoc Publicity		•	Yes	Yes	Yes	Yes
Corporate Governance		•	No	No	No	No
Management Transactions		•	Yes	No	No	No
List of Insiders		•	No	No	No	No

(1) Provided that no exemptions were granted according to Art. 4 para. 1 DPETP.
(2) Further standards possible according to Directive on Financial Reporting

■ Listing
■ Being Public

In the following descriptions of the Issuer and Securities Requirements, the focus is on the requirements for equity securities listed under the Main Standard.

National Treatment and Reciprocity. The Listing Rules do not make any substantial distinction as to whether the issuer of securities is a domestic or a foreign entity.

The foreign issuer must only provide documentary evidence that it is validly organised and existing under its own legislation and that the securities to be traded have validly been issued under the applicable law.

Issuer Requirements. The Listing Rules establish minimum requirements for the issue of securities on the SIX Swiss Exchange listed under the Main Standard. The issuer must have existed as a company for a minimum of three years and presented its annual accounts for the three complete financial years that precede the submission of the listing application.[32] This requirement is intended to show to the investors whether the course of business of the issuing company is stable or its business results are subject to large unforeseen fluctuations from year to year.

However, the SIX Swiss Exchange allows exceptions to this rule, if such exception is in the interest of the issuer or the investors and if the issuer represents that the investors have been provided with all information necessary to form a well-founded decision on the investment.

In this context, the SIX Swiss Exchange may require that additional information be included in the listing particulars. Provided the above-mentioned conditions are fulfilled, the SIX Swiss Exchange may grant an exemption from the 'Three Years Rule' to banks or securities dealers subject to the supervision of FINMA or an equivalent foreign supervisory authority.

The net equity of the issuer must amount to at least CHF 25 million. If the issuer is the parent company of a group, this requirement refers to consolidated capital resources. The SIX Swiss Exchange may establish stricter requirements for issuers of derivatives, particularly with respect to supervision by the authorities, as well as to capital resources and the evidence thereof.

If the issuer is a state, a municipality, or any other public sector body, the requirements must be fulfilled by analogy. It is possible that a third party fulfils certain listing requirements in lieu of the issuer if such third party provides a guarantee commitment with respect to the obligations associated with the securities. In such case, the listing prospectus must also contain information about the guarantor.[33]

The SIX Swiss Exchange has established special rules for certain categories of issuers. Investment companies (i.e., companies with the purpose, either exclusively or at least as their principal activity, of generating yields and/or capital gains, without pursuing active entrepreneurial activities) are exempted from complying with the requirements to have been in existence, and to present annual accounts, for at least three years.

Investment companies incorporated abroad which do not apply for an authorisation to trade under the Swiss Investment Fund Act must show that

32 Listing Rules, arts 10 *et seq*.; Directive on Exemptions regarding Duration of Existence of the Issuer (Track Record); Directive on Financial Reporting; Directive on the Presentation of a Complex Financial History in the Listing Prospectus.

33 Directive on Guarantee Commitments.

investors are able to similarly exercise their participation and property rights as under Swiss company law. Real estate companies (companies which earn at least two-thirds of their income from real estate activities, i.e., from rental or lease income or from real estate services) also are exempted from complying with the 'Three Years Rule'.

Companies listed on the SIX Swiss Exchange under the special provisions for young companies are characterised by their purpose of opening up new markets for their products, utilising innovative technologies, or developing new products or services. These companies must produce audited financial accounts for a minimum of one full fiscal year.

The applicant must provide evidence that he himself and any of his shareholders, including members of management, who, prior to the placement of their securities, directly own more than two percent of the outstanding share capital or control more than two percent of the voting rights of the issuer, jointly and severally agree not to sell any of their equity securities within a time period of at least six months subsequent to the first trading day of the securities being placed (lock-up undertaking).

Securities Requirements. Equity securities listed under the Main Standard must be issued in accordance with the law to which the issuer is subject to and correspond to the provisions validly applicable on the issue of such securities.[34] The SIX Swiss Exchange issued provisions with respect to the applicable law and the place of jurisdiction of debt securities and derivatives to be listed on the SIX Swiss Exchange, thus taking account of the practice on international markets.

Under the provisions, debt securities and option conditions must no longer be subject to Swiss law and it is no longer required that investors have the right to sue the issuer in Switzerland with respect to this contractual relationship. However, the issuers must provide for an alternative place of jurisdiction in the country the laws of which govern the securities. The requirement of a place of jurisdiction in the country to whose law the terms of the securities are subject can be derogated in the case of securities issued by public sector issuers, provided that national law requires a domestic place of jurisdiction for a public sector issuer and the issuer waives its legal immunity in terms of due process and enforcement law in the framework of the applicable.

The fact that the debt securities are subject to foreign law and a foreign place of jurisdiction must be stated in a prominent place in the listing particulars. If these circumstances imply special legal consequences for investors that are different from usual market practice in Switzerland, they need to be clearly disclosed.

Substantive Requirements. Distribution of equity securities listed under the Main Standard among the public ('free float') must, at the latest by the time of listing, have reached a level at which proper market trading can be expected to take

34 Listing Rules, arts 17 *et seq*.; Directive on the Form of Securities.

place.[35] An adequate level of free float is considered to have been reached if at least 25 per cent of the issuer's outstanding equity securities of the given category are in the hands of the public and the capitalisation of those securities in public ownership amounts to at least CHF 25 million. These provisions apply in the case of equity securities to be listed for the first time. The nominal value of a debt issue must amount to at least CHF 20 million. The minimum capitalisation requirement for derivatives and for exchange-traded products is CHF 1 million.

Tradability and Servicing. Securities must be tradable. Securities which are not fully paid up, as well as securities whose transfer is subject to approval or securities that are subject to sales restrictions, may be listed if their tradability is guaranteed and there is no risk to the fulfilment of a transaction.[36]

The issuer must ensure that services pertaining to dividend, interest, and capital payments, as well as all other normal administrative duties, including the receipt and handling of exercise notices for derivatives, are provided in Switzerland. The issuer may assign these duties to a third party if such party has the required professional and technical capabilities available in Switzerland. The party must be a bank, a securities dealer, or some other institution that is subject to supervision by FINMA or the Swiss National Bank.

Equity securities of an issuer incorporated in a third state which are not listed either in that state or in the state in which a majority of its shares are held may be listed only if it can be proven that the absence of a listing in such state is not due to non-fulfilment of investor protection regulations.

Convertible debt securities may be listed if the equity securities to which they relate have already been admitted to the SIX Swiss Exchange or to another regulated market or are being admitted at the same time. The SIX Swiss Exchange may waive this requirement if it is satisfied that the information necessary for investors to reach an informed assessment of the value of the underlying equity securities is accessible.

Conditions for Listing Foreign Shares. For the listing of foreign original shares, the deliverability in Switzerland of the legally certificated securities must be ensured.[37] For the safekeeping of such securities in the home country of the issuer, the following conditions need to be met to fulfil the 'deliverability' requirement:

The original shares are to be held in safekeeping at the national clearing organisation with which SIX SIS Ltd (formerly SIS Sega-Intersettle Ltd) has direct connections. If no such national clearing organisation exists in the home country, or if a direct connection with SIX SIS Ltd is impossible to be established for other reasons (primarily of a legal or technical nature), the SIX Swiss

35 Listing Rules, art 19; Directive on the Distribution of Equity Securities.
36 Listing Rules, arts 21 *et seq*.; Trading Guide SIX Swiss Exchange; Rule Book of the SIX Swiss Exchange.
37 Listing Rules, art 25; Directive on the Listing of Foreign Companies.

Exchange will rule on the matter on a case-by-case basis. The individual delivery of original shares to Switzerland must be ensured; the associated costs may not be prohibitively high and delivery time may not be too long.

Prospectus Requirements. The Listing Rules of the SIX Swiss Exchange contain detailed provisions regarding the contents of the prospectus to be published in connection with the issue of equity or debt securities as well as derivative products.[38] These rules have contributed to raise the information standards to the level of the most important European trading places.

In particular, the prospectus must contain information on the issuer, including its annual accounts and auditors' report, and on the guarantor (if any), on its corporate bodies and the business relations therewith (including stock option plans), on its business activity and investment policy, on its capital and the rights attached to the respective securities, on the securities to be issued, and on the persons or companies bearing responsibility for the contents of the listing prospectus. The listing prospectus may not contain inflammatory or promissory representations. Detailed annexes to the Listing Rules (prospectus schemes) show the information to be provided in the prospectus in case of issued equity, debt, derivate securities, and exchange-traded products.

The SIX Swiss Exchange has established special requirements as to the contents of the prospectus for certain types of issuers. For example, investment companies and real estate companies are obliged to include a detailed description of their investment policy.

The listing prospectus may be published in a choice of German, French, Italian, or English and printed in one or more newspapers with nation-wide circulation or made available free of charge by the applicant in printed form at the issuer's head office and at those financial institutions that are placing or selling the securities.

Moreover, the listing prospectus also may be published in electronic form on the issuer's website, in which case investors must still be sent a printed version free of charge on request.

If material changes in the information included in the listing prospectus or in any equivalent document occur between the time of publication and the lodging of such document, these changes also must be published.

Corporate Governance. The Stock Exchange Act and the Banking Act contain certain corporate governance rules (see text, above) that constitute a prerequisite for the granting of the licence.

In addition, general corporate law provides for certain non-transferable duties of the board of directors of Swiss companies, in particular the ultimate management of the company and the organisation of its financial control.[39]

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38 Listing Rules, arts 27 *et seq*.; Prospectus Schemes A – G; Directive on Financial Reporting; Directive on the Presentation of a Complex Financial History in the Listing Prospectus.

39 Code of Obligations, art 716a, al 1.

On 3 March 2013, the Swiss decided in a nation-wide vote to amend the Constitution as proposed by a constitutional initiative (the so-called "Minder Initiative"). The Minder Initiative toughens the formal corporate governance regime for listed companies and establishes rules concerning say-on-pay:[40]

- The aggregate compensation of the board of directors and the senior management will be subject to the approval of the general meeting of shareholders;
- Severance payments (golden parachutes), advance payments, and similar extraordinary payments to directors or senior managers, as well as multiple contracts between directors and senior managers and group companies, will be prohibited;
- The articles of association will have to include rules for directors and senior managers on loans, retirement benefits, incentive and participations plans, and the number of positions outside the group;
- The chairman of the board, the board members, the members of the board's compensation committee, as well as the independent proxy will have to be elected annually by the AGM; and
- Companies will no longer be allowed to act as corporate proxies and will need to allow shareholders to cast their votes electronically from a remote location.

As a result of the constitutional amendment, a say-on-pay bill will have to be drafted and passed by the legislator. Before (and subject to) the enactment of the bill into law, the Federal Council has to issue an implementing ordinance so that the new constitutional principles become effective as soon as possible. End of June 2013, the Federal Council published its preliminary draft ordinance on the Minder Initiative. The definitive ordinance is expected to be issued in November 2013 and the Federal Council plans for the definitive ordinance to become effective on 1 January 2014. Assuming no extension is introduced in the definitive version, the rules on the election of the Chairman, the other members of the Board, and of the compensation committee will have to be complied with at the first ordinary general meeting in 2014. The companies' articles and organisational regulations will have to be amended within two years following the entry into force of the definitive ordinance. Proper say-on-pay regimes covering fixed compensations will have to be in place at the second general meeting following the entry into force of the definitive ordinance and say-on-pay for variable compensation will apply for the first business year beginning after the entry into force of the ordinance.

Listing Procedure. The listing procedure in respect of any kind of securities is regulated in the SIX Swiss Exchange Listing Rules.[41]

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40 Federal Constitution, art 95, al 3.

41 Listing Rules, arts 42 *et seq*.; Directive on the Procedures for Equity Securities; Directive on the Procedures for Debt Securities; Directive on the Procedures for Exchange Traded Products.

Listing Application. A listing application must be lodged with the SIX Exchange Regulation (formerly Admission Board) of the SIX Swiss Exchange at least 20 trading days prior to the date scheduled for the listing. This application must be made by a person considered by the Regulatory Board of the SIX Swiss Exchange to be experienced (recognised representative).[42]

If the issuer does not employ a person with sufficient experience, the issuer must be represented by such an experienced person, usually a bank or a law firm. The application must include a short description of the securities, a statement of readiness to pay the listing charges, and a declaration that:

- The responsible bodies of the issuer are in agreement with the listing;
- The listing prospectus and the listing notice (only for equity securities) are complete;
- There has been no material deterioration of the issuer's financial position since the publication of the listing prospectus; and
- The issuer has taken note of the disclosure requirements and the sanctions' system under the Listing Rules and is prepared to subject itself to the procedures and decisions of the regulatory bodies of the SIX Swiss Exchange.

The issuer must sign a separate declaration of consent in which it acknowledges the SIX Swiss Exchange's legal foundations and, specifically, its arbitration clause.[43] Furthermore, the application must be accompanied by several annexes in the prescribed number of copies, namely:

- Listing prospectus;
- Listing notice (only for equity securities);
- Declaration that the printing regulations of SIX SIS Ltd have been maintained (if applicable) or a photocopy of the global certificate;
- Extract from the Commercial Register;
- Articles of incorporation; and
- Declaration by the lead manager of the issuer that the securities are sufficiently distributed among investors.

The SIX Exchange Regulation may require explanatory statements and further information. If the application complies with the Listing Rules, the SIX Swiss Exchange Regulation must approve the application.

Provisional Admission to Trading. Debt securities and derivatives (but not shares) intended for listing may be admitted provisionally to trading. In its application, the issuer must describe the securities and provide an assurance that all listing conditions have been fulfilled, and that a listing application will follow.

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42 Listing Rules, art 43; Directive on the Recognition as Competent Issuers and Representatives.

43 Listing Rules, art 45 (4); Additional Rules for the Listing of Bonds, art 16 (3); Additional Rules for the Listing of Derivatives, art 23 (3).

If the application for the listing is not lodged within two months, the admission to the provisional trading automatically lapses. Securities admitted provisionally are traded in a separate segment.

Foreign Issuers. For equity securities of foreign issuers which are traded on an official stock exchange with equivalent listing provisions in the home country, the Regulatory Board of the SIX Swiss Exchange has issued in a special directive general exemptions from particular obligations contained in the Listing Rules.[44] Foreign issuers may choose between primary and secondary listings.

Regular, Periodic, and Ad Hoc Disclosure

Regular Reporting Obligations

The stock-exchange laws provide for regular reporting obligations within the context of maintaining a listing.[45] These reporting obligations are intended to ensure that the technical and administrative information on listed securities are made available by the issuer to the SIX Swiss Exchange and the market participants in a timely manner and suitable form.

The SIX Swiss Exchange has issued a circular, which sets out the reporting requirements for equity and debt securities as well as collective investment schemes, in order to make the technical and administrative work involved with the reporting requirements easier for issuers.[46] Since 2009, the SIX Swiss Exchange operates a reporting platform called CONNEXOR. Since 1 April 2013, issuers with primarily listed equity securities are obliged to use CONNEXOR reporting.

Periodic Disclosure

Financial Statements and Accounting Principles. Under Swiss corporate law, listed companies must publish their annual report, including business report and annual financial statements, in accordance with generally accepted accounting principles. If the company is listed on the SIX Swiss Exchange, these documents also must be filed with the SIX Swiss Exchange within four months after the end of every financial year.

In addition, the annual report must be made available in electronic form on the website of the issuer for five years after its publication. Companies listed on the SIX Swiss Exchange must observe IFRS, United States GAAP, or other internationally recognised accounting standards or Swiss GAAP FER for the Domestic Standard (for smaller Swiss companies) and for real estate companies. As a consequence of globalisation of the capital markets, Swiss public companies are more and more applying IFRS or even United States GAAP.

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44 Directive on the Listing of Foreign Companies.

45 Listing Rules, arts 49 *et seq*.

46 Circular Number 1 — Reporting Obligations regarding the Maintenance of Listing.

With regard to the financial reporting of issuers listed on the SIX Swiss Exchange, the SIX Exchange Regulation is responsible for monitoring compliance with the Listing Rules and the recognised accounting standards.[47]

Corporate Governance Report. The SIX Swiss Exchange has issued a directive on corporate governance, which requires all issuers whose equity securities are listed on the SIX Swiss Exchange to disclose important information on their board and senior management (or to give substantial reasons why this information is not disclosed) in a separate section of the annual report.[48]

While maintaining decision-making capability and efficiency at the highest level of a company, these principles are intended to guarantee transparency and a healthy balance of management and control. The Directive on Corporate Governance itself establishes the basic principles.

Details on what information is to be disclosed are indicated in the annex to the directive. The SIX Swiss Exchange has provided guidance to the issuers as to the disclosure requirements under the Directive on Corporate Governance in a commentary.

Swiss public companies are required to disclose detailed information on the compensation of the members of the board and senior management and their shareholdings as well as loans received in the notes to the financial statements.[49] Foreign companies listed on the SIX Swiss Exchange have to disclose information on compensation in the Corporate Governance Report instead.

Interim Statements. Under the SIX Swiss Exchange Listing Rules, issuers of listed equity securities are further obliged to publish an interim financial report.[50] The interim financial report, which needs to be audited, must cover a time frame of six months or less.

The same accounting principles that have been used in the annual financial statement are to be applied in the interim financial report. However, there is no requirement for the interim financial report to be audited.

The interim report must be published within three months after the end of the relevant period and filed with the SIX Swiss Exchange no later than its publication and must be made available in electronic form on the website of the issuer for five years after its publication.

Special Companies. In their semi-annual and annual financial statements, real estate and investment companies must fulfil disclosure requirements that extend

47 Listing Rules, arts 49 *et seq*.; Directive on Financial Reporting with the recognised accounting standards IFRS, United States GAAP, and Swiss GAAP FER.

48 Directive on Information Relating to Corporate Governance; Commentary on the Corporate Governance Directive.

49 Code of Obligations, arts 663*bis et seq*.

50 Listing Rules, arts 50 *et seq*.; Directive on Financial Reporting.

beyond the stipulations of the given accounting standard. In justified cases, SIX Swiss Exchange may require the delivery of an interim report at shorter intervals.

The interim report of investment companies comprises the composition of and changes in investments and in current value, as well as supplementary notes (e.g., events of special significance). In addition, investment companies must publish the net asset value of their securities at regular intervals.

Foreign Issuers. The periodic reporting obligations under the SIX Swiss Exchange Listing Rules are not limited to issuers established in Switzerland, but apply to all issuers whose securities are listed on the SIX Swiss Exchange, regardless of their legal incorporation (not so for corporate law disclosure requirements). An exception only exists for issuers whose equity securities are admitted exclusively on the basis of a secondary listing on the SIX Swiss Exchange.

With respect to such secondary listings, the aim is to ensure that all information that an issuer publishes in his home country also is made available to the SIX Swiss Exchange and market participants in Switzerland.

When filing the listing application, the introducing bank must accept the responsibility to forward such information accordingly and provide evidence that the disclosure requirements of the primary stock exchange are substantially equal to those of the SIX Swiss Exchange Listing Rules. In addition, the SIX Swiss Exchange has concluded agreements with individual foreign stock exchanges having the purpose of information exchange.

Ad Hoc Publicity

Price-Sensitive Facts. The SIX Swiss Exchange Listing Rules state an obligation for the issuer to inform the market of any price-sensitive facts which have arisen in its sphere of activity and are not of public knowledge.[51] Price-sensitive facts are facts that, due to their considerable effect on the issuer's assets and liabilities or financial position or on the general course of business, potentially result in substantial movements in the price of the securities.

This disclosure duty was introduced essentially to minimise insider trading and ensure all market participants an equal treatment to the greatest extent possible. Hence, the issuer must see to it that all market participants are informed in the same manner and at the same time. The issuer should structure the contents of the notification in such way that the statement can be instantly assessed by the average market player with regard to the price-sensitive fact.

The SIX Swiss Exchange has issued a directive and a detailed guideline as to the handling of the ad hoc publicity.[52] However, the SIX Swiss Exchange deliberately refrains from defining price sensitivity in percentage terms. The market

51 Listing Rules, art 53.
52 Directive on Ad Hoc Publicity; Commentary on the Directive on Ad Hoc Publicity.

parameters for the security in question, as well as the investors' expectations and level of information, are decisive factors in determining whether an event has a potential substantial price impact.

Examples of price-sensitive facts are changes in structure (such as mergers, substantial acquisition, and far-reaching organisations), changes in share capital, material changes in earnings situations ('profit warning' in so far as certain profit expectations were announced by the issuer), changes in the course of business (cessation of a main sphere of business, entry into a strategic alliance, or a major case of product liability), and changes in the board and senior management.

Time of Disclosure. The issuer must provide information without delay as soon as it has knowledge of the main points of the price-sensitive facts in question. However, in certain exceptional cases, it may postpone the disclosure of such information if the new facts are based on a plan or decision of the issuer, and its dissemination could negatively affect the legitimate interests of the issuer. In such case, the issuer must guarantee the complete confidentiality of such facts.

Whenever possible, ad hoc disclosures have to be made outside of the ordinary trading hours and 90 minutes before trading commences at the latest. If that is not possible and an intraday announcement is necessary, for example, because of a leak, the disclosure office of the SIX Swiss Exchange has to be notified, which will decide whether to stop trading until the information has disseminated.

The SIX Swiss Exchange may require the issuer to disclose specific information. Should the issuer fail to comply with this requirement, the SIX Swiss Exchange may itself publish such information after having heard the issuer.

Management Transactions. The rules of the SIX Swiss Exchange require the disclosure of management transactions, which imposes on issuers to report transactions concluded by members of their board of directors and executive committee in the given company's equity securities, convertible and purchase rights on the company's shares, and financial instruments whose price is materially dependent on the company's own equity securities.[53]

Members of the board of directors and executive committee must report to their issuing company all transactions that fall within the scope of these regulations within two trading days.

The issuer must submit to the SIX Exchange Regulation through the electronic reporting platform within three further trading days a report that discloses, among other things, the name and function of the individual (i.e., executive member of the board of directors, member of the executive committee, or non-executive member of the board). The SIX Exchange Regulation will then publish the report

53 Listing Rules, art 56; Directive on the Disclosure of Management Transactions; Directive on Electronic Reporting and Publication Platforms; Commentary on the article 56 of the Listing Rules and the Directive on the Disclosure of Management Transactions.

on its website without the individual's name, however, with an indication of the given individual's function.

Trading Rules

Securities Offerings

Offering of Shares. Basically, an offering can be a primary offering or a secondary offering. Primary offerings involve the creation and distribution of newly issued shares, whereas secondary offerings involve the sale of existing shares.

Unless the shares are placed among a determined and small circle of investors (private placement), a prospectus must be made available to the investors in either event. Often, the creation of new shares and their distribution to the public is accompanied by the selling of already existing shares in the market.

The law does not specifically define the concept of private placement. However, under the Banking Act and the Collective Investment Schemes Act, the prevailing view is that offerings made to a maximum of 20 persons is deemed to qualify as a private offering. If more than 20 persons are approached in the context of a promotional action, the offering is likely to be deemed public.[54]

In the context of a public offering outside of the SIX Swiss Exchange, a prospectus according to article 652a of the Code of Obligations must be issued if the new shares are issued and offered publicly. However, the information to be delivered in this prospectus is quite limited (contents of the registration in the commercial register, existing amount and structure of the capital stock, provisions in the articles of incorporation concerning an authorised or a conditional increase of the capital, number of benefits certificates and specification of the rights associated therewith, the last annual financial statements, consolidated financial statements, together with a report of the auditors, dividends paid within the last five years or since the date of incorporation, and resolution concerning the issuance of new shares). If the shares are offered on the SIX Swiss Exchange, the listing and publicity requirements of the Listing Rules and the applicable prospectus schemes apply.[55]

Underwriting Agreement. Usually, the offering of shares involves investment banks subscribing securities on a firm commitment basis, thus assuming the risk of the distribution. The main point to be agreed in the underwriting agreement between the issuer (or selling shareholder) and the investment banks is the offering price, which is not determined until just before the offering takes place since it must be in relation to the current market conditions.

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54 Under the draft amendment of the Swiss stock corporation law, which, as of the time of writing, is still pending in Parliament, a prospectus would not be required if the promotional action is solely directed at "qualified investors" as defined pursuant to the Collective Investment Schemes Act (cf. Draft-Code of Obligations, art 652a, al 4).

55 Listing Rules, arts 27 *et seq*.; Prospectus Scheme A – Equity Securities.

Therefore, the underwriting agreement is usually finalised and signed on the day before the effective date of the offering. Until this point, the relationship between the parties is usually governed by a letter of intent or engagement letter that is for the most part a non-binding agreement. However, parties have started to sometimes attach a standard underwriting agreement to the engagement letter according to which the final agreement will substantially be in line with the attachment.

Deposit and Subscription Agreement. In the event of a primary offering of Swiss shares, the entering into a nominal amount deposit and subscription agreement has become customary. This agreement ensures that the new shares are duly issued under Swiss law and covers the following topics:

- Confirmation that the shareholders' meeting has resolved or will resolve the increase of the share capital by issuing a certain number of shares and that the statutory pre-emption rights have been or will be waived;
- Undertaking of the co-ordinators of the bankers' syndicate to subscribe the new shares and to deposit an amount equivalent to the nominal value of the shares in a blocked bank account;
- Undertaking by the company to procure the registration of the capital increase with the commercial register;
- Undertaking of the co-ordinators to sell the newly created shares in a public offering subject to the conditions of the underwriting agreement; and
- Exit clause for the banks in case the underwriting agreement is not signed or is terminated prior to the closing date.

Offering of Debts Securities. Public offerings of bonds require publication of a prospectus in accordance with article 1156 of the Code of Obligations. If the bonds are listed, additional information must be provided in the listing prospectus as required by the Listing Rules and the applicable prospectus schemes.[56] Notes are usually medium-term papers with a maturity of five to seven years and privately placed, usually with clients of the syndicate banks.

In recent years, medium-term notes programmes have become quite common, allowing an issuer to issue medium-term papers with maturity of up to five years in several tranches and on several stock exchanges. Unless the Listing Rules of the SIX Swiss Exchange apply, the issue and the placement of notes is regulated by Convention XIX of the Swiss Bankers' Association, which provides for particular prospectus information.

Likewise, the offering of bonds and notes are usually purchased by a syndicate of banks that will place them either on the stock exchange or in a closed circle of investors, thus bearing the risk of distribution. The terms of the bonds are quite standard, and they include:

- Form, denomination, printing, and reopening;

56 Listing Rules, arts 27 *et seq*.; Prospectus Scheme E – Bonds.

- Interest;
- Redemption;
- Transfer of funds by the issuer;
- Taxation;
- Status (*pari passu*) and negative pledge;
- Repayment in events of default;
- Consolidation, merger, or sale of assets;
- Replacement of debtor;
- Prescription;
- Listing; and
- Sales restrictions.

According to the Additional Rules for the Listing of Bonds and the Additional Rules for the Listing of Derivatives of the SIX Swiss Exchange, it is no longer required that debt securities and derivatives be governed by Swiss law to qualify for the listing on the SIX Swiss Exchange. Debt securities and derivatives may now be subject to the governing law of any Organisation for Economic Co-operation and Development (OECD) country as well as other legal systems recognised by the Regulatory Board of the SIX Swiss Exchange.

Furthermore, it is no longer required that investors must be able to enforce their rights under the debt securities or derivatives in Switzerland. Issuers and the holders of the securities can agree to submit to the courts of any jurisdiction, provided that a place of jurisdiction must be available in the country the laws of which govern the securities. However, the provisions of the SIX Swiss Exchange allow an exemption from this rule with regard to debt securities and derivatives issued by an issuer of the public sector if local law requires a domestic place of jurisdiction for a public sector issuer and the issuer waives its legal immunity in terms of due process and enforcement law in the framework of the applicable legislation.

Offering of Derivatives. Derivative instruments are traded either on EUREX if they are standardised or on Scoach in case of warrants and structured products or over-the-counter market if they are customised. Derivatives may be listed on the SIX Swiss Exchange, provided the issuer is a licensed Swiss bank subject to the Federal Banking Act, a licensed Swiss securities dealer subject to the Stock Exchange Act, or the issuer is subject to a comparable foreign supervision.

The same applies to derivative securities entitling to purchase shares or bonds issued by the issuer of such derivatives. Even though the contents and the documentation of over-the-counter derivatives securities may vary from product to product, the use of international market standards in Switzerland has become more and more common; in particular, the ISDA Master Agreements and the Swiss Master Agreement, together with their respective schedules, are increasingly popular. The main purpose of these agreements is to reduce capital adequacy requirements for the banks, on the one hand, and the counterpart risks, on the other hand, by stating far-reaching netting clauses.

With respect to the enforceability of such clauses in the event of a bankruptcy, the Federal Act on Debt Enforcement and Bankruptcy now provides for automatic termination of all transactions involving financial futures, swaps, and options, which can be valued based on market or stock exchange prices as at the time of the opening of the bankruptcy, thus preventing any 'cherry-picking' by the bankruptcy administration in enforcing individual rights of the bankrupt debtor. However, since the aforementioned Master Agreements are generally subject to English or New York law, the enforceability of their clauses, in particular their netting clauses, under Swiss law must always be checked.

Disclosure of Acquisition of Substantial Holdings

In General. The Stock Exchange Act provides in its articles 20 and 21 for the obligation to have substantial holdings disclosed by their owners and thereafter by the concerned legal entity. The disclosure obligation applies to Swiss companies having at least one class of equity securities listed on a stock exchange in Switzerland and, pursuant to a recent amendment, to companies not domiciled in Switzerland whose equity securities are mainly listed in Switzerland.[57] Further (partial) disclosure rules also exist in other laws. Article 663c of the Code of Obligations requires Swiss corporations having their shares listed on a stock exchange to disclose in the notes to the balance sheets the significant shareholders (owning more than five per cent equity in the corporation), provided the management knows or ought to know of such shareholders; the effects of this provision, however, are limited due to many disadvantages, namely:

- It is difficult to know the shareholders in case of bearer shares;
- The corporation is charged with an inquiry duty not related to company matters; and
- The balance sheets are issued only once a year, hence not providing enough transparency for the capital market.

Furthermore, article 663b of the Code of Obligations provides for disclosure of the material participations in other companies. The Collective Investment Schemes Act and the Banking Act contain similar provisions as to the disclosure of significant shareholders.

Shareholder Duties. Shareholders must report the acquisition and/or disposal of equity participations in a listed legal entity if certain thresholds are met.[58] Disclosure is required if a title owner or a group of title owners acquires or disposes, respectively, of equity participations and thereby reaches, exceeds, or

57 Pursuant to article 53b, al 1, of the Stock Exchange Ordinance, the equity securities of a company not domiciled in Switzerland are mainly listed in Switzerland when the company must fulfil at least the same duties and maintenance of a listing on a stock exchange in Switzerland as a company domiciled in Switzerland. The list of companies not domiciled in Switzerland that have their main listing on the SIX Swiss Exchange is available at www.six-exchange-regulation.com/obligations/disclosure/foreign_companies_en.html.

58 Stock Exchange Act, art 20, al 1.

falls below the limits of 3 per cent, 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 33-1/3 per cent, 50 per cent, or 66-2/3 per cent of the voting rights of the concerned company.

Some thresholds correspond to specific minority rights (in particular, 10 per cent of capital stock provide the right to call up a shareholders' meeting, the right to initiate a special audit, and the right to claim for dissolution of the company) or majority quorums respectively (66-2/3 per cent of the votes and absolute majority of the par value present at the shareholders' meeting allow to take important decisions as described in article 704 of the Code of Obligations) under the Swiss stock corporation law. The term 'acquisition and disposal' includes all types of equity transfers including share exchanges, donations, inheritances, conversions of shares, and usufructuary rights. The obligation to notify arises at the time when the respective contract is concluded.

The disclosure obligation concerns equity participations; since most legal entities listed on the SIX Swiss Exchange are stock corporations, in practice all substantial share transactions must be disclosed. The key element is the voting right, not the capital amount; therefore, all transactions that have the effect of conferring the voting right relating to equity securities (e.g., in the business of securities lending and repurchase agreements) are subject to the disclosure obligation.

Furthermore, after long discussions, the legislator has decided that the acquisition and disposal of equity derivatives, such as call options and conversion rights, regardless of whether the terms of the derivatives give the right of physical delivery of the underlying equity securities or allow for cash settlement, are subject to the disclosure obligation. Financial instruments, other than those mentioned, must also be reported if their structure permits an entitled person to acquire equity securities, if these are acquired, sold, or granted (written) in respect to a public takeover offer.

The disclosure obligation in case of an acquisition of equity securities for the own account is obvious. However, the financing of an indirect acquisition also must be reported, meaning that a beneficial owner of equity securities remains as fully responsible for the notification as the formal owner. For example, in the framework of a fiduciary arrangement, the principal (beneficial owner) and the trustee (formal owner) must disclose if any of them exceeds any relevant threshold. Special rules apply in respect of investment funds, trusts, and pension funds: Their management is responsible to deliver the notification since only such body has a proper control of the investments.

Special disclosure events are given if a company increases, restructures, or reduces its capital, if a company buys or sells its own equity securities, and if in-house funds of financial intermediaries buy or sell equity securities.

Recently, the ordinance specifying the disclosure requirements was partially amended. The changes focused on easing the requirements for foreign collective investment schemes to take advantage of the exception regarding the obligation to

consolidate with respect to the disclosure requirements.[59] Furthermore, exemptions from the disclosure obligation have been broadened to include circumstances where threshold values are exactly reached.[60]

Organised Groups. Organised groups of equity securities holders and such holders acting in concert have the privilege of complying with the disclosure obligation as a whole.[61]

The privilege applies to groups of companies and companies under common control, to equity securities holders who establish or terminate agreements relating to the exercise of voting rights, and/or to relationships to acquire or dispose of equity securities.

In specific cases, however, it might be debatable whether an 'agreement' or only a loose (not directly discussed) understanding between titleholders exists; the supervisory authority has established some guidelines in the meantime.

The group must report the grand total of its title holdings, the identity of its members, the nature of the arrangement, and the representation of the group. Title transactions within the group, however, are not subject to the disclosure obligation.

Procedural Aspects. A holder of equity securities subject to a disclosure obligation must report the relevant transaction, both to the concerned company and to the stock exchange on which the securities are listed. The details which need to be mentioned in the specific notice are specifically listed in the ordinance to the Stock Exchange Act; special forms for various situations are available on the SIX Swiss Exchange website.

The SIX Swiss Exchange has issued compliance procedures that must be observed by the concerned holders of equity securities. In case of doubt about the scope and contents of the disclosure obligation in respect of a specific transaction, the possibility exists to obtain a preliminary ruling from the competent supervisory authority of the stock exchange that will be given according to a special ordinance.

In special cases, the supervisory authority of the stock exchange also may exempt a holder of equity securities from a reporting requirement. An important reason for such an exemption is given if the relevant threshold is only exceeded for a short time, if the acquirer has no intention to exercise the voting rights of the concerned company, if a securities dealer is building a trading position for several customers, or if the transfer of the equity securities is subject to a condition precedent. To obtain the exemption, the application must be made to the stock exchange in good time, before carrying out the transaction in question.

59 Stock Exchange Ordinance-FINMA, arts 17, al 3, 3*bis,* and 3*ter*.
60 Stock Exchange Ordinance-FINMA, art 9, al 4.
61 Stock Exchange Act, art 20, al 3.

Company Duties. The company must publish any information it receives relating to changes in the ownership of its voting rights.[62] The details about timing (usually two business days), form, and relevant media are regulated in the ordinance to the Stock Exchange Act. Publication takes place via the electronic publication platform operated by the Disclosure Office and can be accessed on the website of the Disclosure Office.

Article 21 of the Stock Exchange Act refers to the information received by the company. Therefore, the question arises of how the company should react if no information is given by the titleholder, but the fact of having exceeded a threshold has become known to the company otherwise. The legal doctrine is of the opinion that a company is not obliged to inquire into the details of title holdings; however, the company should take up the matter if it has good reasons to assume that a notification must be made.

Insider Trading and Price Manipulation

New Market Abuse Regime. As part of a significant overhaul of the Stock Exchange Act, the regulation of the offences of insider trading and price manipulation has been transferred from the Swiss Criminal Code to the Stock Exchange Act. Both offences will henceforth be prosecuted by the Office of the Attorney General of Switzerland and judged by the Swiss Federal Criminal Court, and no longer by cantonal prosecution authorities.

The new rules in the revised Stock Exchange Act, which came into force on 1 May 2013, provide standards in both criminal and administrative law that sanction market abuse on a broad basis and take account of international standards. The Stock Exchange Act first addresses the administrative law sanctions to be imposed on enterprises and then the criminal law sanctions applied on individuals.

Criminal Law Provisions. The Stock Exchange Act, as amended, has considerably broadened the scope of the insider trading prohibition as it now encompasses the liability of every individual person. It includes several categories of insiders: 1) a body or a member of a managing or supervisory body of an issuer or of a company controlling or controlled by the respective body, or a person who due to his or her holding or activity has legitimate access to insider information (primary insider); 2) whosoever receives insider information disclosed to them by a primary insider or acquired through a crime or a misdemeanour (secondary insider); and 3) whosoever accidentally receives insider information (fortuitous insider). All three groups of insiders are liable if they gain a pecuniary advantage for themselves or for others by exploiting insider information to acquire or sell securities or to use financial instruments derived from such securities. Primary insiders are moreover sanctioned if they gain a pecuniary advantage for themselves or for others by disclosing insider information to others or by exploiting it to recommend to others to acquire or sell securities or to use financial instruments

62 Stock Exchange Act, art 21.

derived from such securities.[63] In this context, insider information means information the publication of which may materially affect the price of securities or financial instruments.

The insider trading prohibition is completed by a further provision which penalises whosoever materially influences the price of securities with the intention of gaining a pecuniary advantage for him- or herself if he or she disseminates false or misleading information contrary their better knowledge as well as effects purchases and sales of such securities directly or indirectly for the benefit of the same person or persons connected for this purpose.[64]

Territorial Link. Both criminal law provisions require that the affected securities are securities admitted to trading on a stock exchange or an institution which is similar to an exchange in Switzerland. This fact corresponds to the intention of the legislator to protect the efficiency and transparency of domestic capital markets.

Swiss criminal law is basically applicable to persons committing a criminal offence in Switzerland. A criminal offence is deemed to have been committed at the place where it has been executed and where the result of the execution has taken place ('Ubiquity Rule'). With regard to the above-mentioned offences, Swiss criminal law will therefore apply if the person committing the offence is acting in Switzerland or if the unjustified gain is realised in Switzerland. If the offender acts from abroad but through an agent in Switzerland (generally, a bank or other securities dealer), the rules of the Swiss criminal law provisions will apply, regardless of whether the agent acted with knowledge of the offence or not.

Several investigations for suspected insider trading had been commenced under the insider trading prohibition pursuant to the Swiss Criminal Code. However, practically none of them resulted in a criminal conviction. The major part of the court decisions concerned cases of international legal assistance requests originating from the United States, France, Germany, and other countries in or outside of Europe, where it had to be decided whether the alleged offence was punishable under Swiss law.

Administrative Law Provisions. The revised Stock Exchange Act has newly introduced into Swiss administrative law specific statutory provisions against market abuse. These new provisions prohibit all market participants (including legal entities) from engaging in insider trading and market manipulation.[65] Prior to this, FINMA and its predecessor, the Federal Banking Commission, could only enforce market conduct rules against supervised market participants. Moreover, market abuse is more broadly defined in this context than under the criminal law provisions.

63 Stock Exchange Act, art 40.
64 Stock Exchange Act, art 40a.
65 Stock Exchange Act, arts 33e and 33f; FINMA is implementing these new provisions as part of its full revision of Circular 08/38 on "Market conduct rules".

Because of the wide scope of application of the new administrative law provisions on market abuse, the revised Stock Exchange Act and its executing Ordinance have set out conduct, which, albeit captured by the new provisions, is allowed in terms of "safe harbours".[66] These "safe harbours", provided that certain preconditions are satisfied, include: repurchase programs for a company's own securities; securities transactions for the purposes of price management and price stabilisation; securities transactions in preparation of a public takeover offer; securities transactions effected by public bodies in connection with their public mandate; and a special legal status on the part of the recipient of the information.

Public Takeover Bids

In General. The legal provisions related to tender offers in Switzerland are contained in articles 22–33d of the Stock Exchange Act.

The law only provides for some (not always coherent) general principles; major parts of the legal sources are contained in ordinances.[67] Furthermore, the case law and circulars of the Takeover Board are of utmost importance.[68]

Territorial Application. The provisions on tender offers apply in respect of equity securities of Swiss companies of which at least one class of equity securities is listed on a Swiss exchange and, pursuant to a recent amendment, of companies not domiciled in Switzerland whose equity securities are mainly listed in Switzerland.[69]

The Stock Exchange Act does not contain any provisions as to the domicile and the nationality of the offeror (bidder); consequently, these elements are not of importance for tender offers in Switzerland. Certain formalities that usually need to be fulfilled (e.g., annual balance sheets) may even be waived by the Takeover Board if the foreign law of the offeror's incorporation place does not know a respective requirement.

Description of Tender Offer. The Stock Exchange Act covers any kind of public tender offers including share buy-backs (public offers by a company to repurchase its own equity securities), except if the transaction does not exceed two per cent of the equity capital or voting rights of the company and the titleholders are treated equally.[70]

The Stock Exchange Act does not exempt restructurings from the scope of application; however, the Takeover Board may release an exemption recommendation for good reasons subject to the given individual circumstances.

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66 Stock Exchange Ordinance, arts 55a *et seq*.

67 Stock Exchange Ordinance-FINMA; Takeover Ordinance; Regulations of the Takeover Board.

68 See www.takeover.ch.

69 Stock Exchange Act, art 22, al 1.

70 TOB Circular Number 1: Buyback programmes.

Substantive and Procedural Requirements of Tender Offer. An offeror is obliged to extend equal treatment to all holders of equity securities of the same class.[71] If the tender offer is made for several classes of equity securities, the equal treatment principle generally applies (i.e., the tender offer must be extended to all classes of listed equity securities of the target company), but not to unquoted (private) classes of equity securities.

Furthermore, the best price rule requires from the offeror that the highest price paid from the date of the pre-announcement of the tender offer to any titleholder is offered to all titleholders. The Takeover Board even extends this rule to the six months following the close of the offering period; however, this practice has caused critical remarks in the legal doctrine.

The offer price of a mandatory offer must equal or exceed the stock market value of the target — that is, the volume-weighted average share price of exchange-based transactions over the last 60 trading days prior to the pre-announcement or publication of the offer[72] — and may not differ from the highest price paid by the bidder for equity securities in the target during the 12 months preceding the pre-announcement or publication of the offer (minimum price rule).[73]

Where a voluntary tender offer is launched — that is, where the bidder launches a tender offer before the relevant threshold triggering a mandatory offer has been reached or exceeded — the minimum price rule stated above must nevertheless be complied with, to the extent that the offer is made for a number of equity securities the acquisition of which would reach the applicable threshold triggering a mandatory offer.[74]

The offeror may publish a prior announcement before the publication of an offer prospectus. The prior announcement has to contain the substance of the subsequent tender offer, including particulars of the offeror and of the target company, the equity securities at stake, the offering price, the tentative time table of the tender offer, and its conditions, if any. The prior announcement must be published in at least two Swiss newspapers and in at least two principal electronic media.

The details of the tender offer must be published in a prospectus that is correct and complete containing all relevant information suitable and necessary for the investors to appropriately evaluate the tender offer.[75] The exact contents of the prospectus are described in the ordinance to the Stock Exchange Act; specifically, information on the offeror, the object of the tender offer, the target company, the publication of the announcement, the examination of the review body (auditor), and the filing with the Takeover Board must be provided. Furthermore, the offeror

71 Stock Exchange Act, art 24, al 2.
72 Stock Exchange Ordinance-FINMA, art 40.
73 Stock Exchange Act, art 32, al 4.
74 Takeover Ordinance, art 9, al 6.
75 Stock Exchange Act, art 24, al 1.

must declare that it is not in possession of information not being available to a potential competing offeror; this statement causes problems if a due diligence review has been done. In such situation, the Takeover Board requests from the target company that a competing offeror should be granted with the possibility to exercise a similar due diligence review.

Instead of the complete offer prospectus, the offeror may arrange for notice of the offer to be published in at least two Swiss newspapers, provided it contains the information as set out in the Takeover Ordinance, such as the exact internet address at which the complete offer prospectus is available as well as information as to where the prospectus may be obtained free of charge.

If the offeror has a legitimate interest, the offer may be made subject to conditions; however, only conditions may be imposed in the offering documentation that cannot be influenced to a significant extent by the offeror. The usual conditions concern the entry of the offeror as titleholder in the stock ledger and the availability of regulatory approvals (competition authority, financial market supervisory authority). If the offeror is publishing a revised offer, the terms must improve the overall position of the titleholders of the target company.

To achieve full transparency, certain holders of equity securities must report all acquisitions and sales of equity securities in the target company, namely the offeror, parties acting in concert with the offeror, the offeree company, and significant shareholders of the target company who have asserted their party status.[76]

The parties to the proceedings are obliged to publish all transactions in equity securities and related instruments of the target company (and of any securities offered in exchange) on a daily basis, allowing the market participants to closely follow their investments.

Moreover, after the announcement of the tender offer, the offeror and its allied parties are restricted from buying equity securities from the target company at a premium (principle of equal treatment; best price rule).

After the publication of a tender offer, a mandatory 'cooling period' applies which shall normally last 10 exchange trading days. This allows the board of directors of the target company to prepare a report to its titleholders and the Takeover Board to examine the offer and to render a decision. The tender must be open during an offer period of not less than 20 and no more than 40 exchange trading days, subject to a special permission by the Takeover Board to the contrary.

At the end of the initial offer period, the offeror must determine and the review body must confirm the preliminary result of the offer. Thereafter, whether conditions of the offer do or do not exist, the offeror is obliged to extend the offer period for another 10 exchange trading days, thereby giving the holders of equity securities of the target company an additional possibility to tender the titles.

76 Stock Exchange Act, art 31; Takeover Ordinance, arts 38 *et seq*.

In case of competing offers, it is imperative that the holders of the equity securities of the target company are able to choose freely among them and to withdraw from an already given acceptance of a previous tender offer. Therefore, any competing offer must be published not later than the last exchange trading day of the initial offer period. The competing offer must be open for acceptance for as long as the initial offer but not less than 10 exchange trading days, and the initial offer is extended accordingly to synchronise both offers.

If the competing offer expires after the initial offer, the period of the initial offer is automatically extended until the expiry date of the competing offer. In case of a competing offer, the target company's shareholders may revoke their acceptance of the initial offer at any time up to its expiry.

Once a competing offer is made, the initial offeror may not revoke the initial tender offer. However, the initial tender offer may be revised. If several competing offers are made, the target company is obliged to grant equal treatment to all offerors.

A tender offer may be prohibited, by court order or administrative decree, if the terms of the offer or the conduct of any party involved in the offer, including the target company, violate applicable laws. Under these circumstances, holders of equity securities have the right to withdraw their acceptances of the tender offer.[77]

Duties of Target Company. The board of directors of the target company is obliged to issue a report on the tender offer containing all information necessary to allow shareholders to make an informed decision.[78] The report also should contain information about intentions of significant holders of equity securities of the target company and about potential conflicts of interest involving board members and directors.

This topic is very sensitive in practice. If the board is emphasising negative aspects, it is likely that, following a successful tender offer, the members of the board will be immediately replaced; if the board of directors is overestimating the positive aspects, the holders of the equity securities may be misled.

Furthermore, the target company must treat all competing offerors equally. According to the Takeover Board, this principle particularly applies in respect of the possibility of all competing offerors to execute a due diligence review in respect of the non-public (and not specifically protected) information of the target company. However, the report of the board of directors can differentiate in the evaluation of the tender offers, meaning that a better recommendation of an offer, submitted by a 'white knight' offeror, is possible.

The board of directors of the target company is restricted in its ability to introduce defensive measures against tender offers.[79] In particular, from the moment the offer is announced until the publication of the results, the target company may not

77 Stock Exchange Act, art 26.
78 Stock Exchange Act, art 29, al 1.
79 Stock Exchange Act, art 29, al 2.

engage in any transactions that would alter, to a significant extent, the assets or the liabilities of the company.

The main examples in practice are the (conditional) sale of important parts of the business (approach of 'scorched earth', 'crown jewel defence', or 'lock-up agreements'), the conclusion of special agreements in favour of management and directors ('golden parachutes'), the conditional increase of the capital with a unilateral allocation of subscription rights ('poison pills'), and the issuance of new shares or convertible debts with exclusion of subscription rights of existing title holders.

Within the legal framework, the 'pac-man' defence and the 'white knight' defence are possible. Notwithstanding the intensive discussion, these legal provisions have not yet gained a substantial practical importance, with the exception of some preventive effects. After the tender offer has been launched, only the shareholders' meeting of the target company may decide on any relevant defensive measures.

Mandatory Offer Obligation. The most-debated provision of the Stock Exchange Act is the so-called mandatory offer obligation: Holders of equity securities with a large investment in a company (33-1/3 per cent or 49 per cent) are legally forced to make an offer to the remaining holders of equity securities.[80] This obligation could make the acquisition of a substantial part of a company expensive since the smaller title holders also have the possibility to sell their investments.

Nevertheless, a Swiss company may dispose of the obligation to be submitted to the mandatory offer obligation in its articles of association (so-called opting-out). An opting-out may be resolved before or after the equity securities of the company are listed on a Swiss stock exchange.[81] Before the listing, a resolution in the meeting of the title holders must be passed by absolute majority. After the listing of the equity securities, such a resolution may not be illegitimately disadvantageous to the existing rights of the title holders.[82]

The mandatory offer obligation is triggered whenever a holder of equity securities or an allied group of holders directly or indirectly acquires equity securities exceeding the threshold of 33-1/3 per cent of the voting rights of the target company.

This relevant threshold may be raised by a resolution of the target company's holders of equity securities to the higher threshold of 49 per cent (so-called 'opting-up'). The mandatory offer obligation is triggered once a transaction in relevant equity securities brings the owner (and subsequent offeror) to the applicable threshold.

The Stock Exchange Act and its ordinances contain a number of exemptions from the mandatory offer obligation, such as the acquisition of voting rights as a result

80 Stock Exchange Act, art 32.
81 Stock Exchange Act, art 22, al 2, and 3.
82 Code of Obligations, art 706.

of a donation, of a foreclosure sale, or of a corporate reorganisation. Moreover, the Takeover Board or FINMA, respectively, may grant a discretionary exemption or whitewash from the mandatory offer obligation if this appears to be justified under the given circumstances.

The offeror is obliged to buy all outstanding equity securities of the target company at no less than the stock exchange price. This price is designed as the volume-weighted average price on a Swiss stock exchange for the 60 exchange trading days before the publication of the offer or the advance announcement, as the case may be.

Additionally, if the offeror has purchased equity securities prior to the tender offer, the minimum price for the tendered equity securities must be the higher of the stock exchange price or of the highest price paid by the offeror for equity securities of the target company in the 12 months preceding the announcement of the offer.[83]

The price for the tendered equity securities may vary if the target company has issued several classes of equity securities. Under certain specific circumstances, exceptions from the minimum price rule may apply. The mandatory offer must be published within two months after the owner of equity securities (and subsequent offeror) has crossed the relevant threshold except if the Takeover Board extends this time period for important cause. Basically, the same procedural rules apply in a voluntary tender offer.

An offeror may request a squeeze out (being a buy-out right) of the remaining holders of equity securities if, after the tender offer, it holds more than 98 per cent of the voting rights of the target company, including shares already held prior to the tender offer.[84] The cancellation of equity securities is effected by court order.

Approaches to Jurisdictional Conflicts

Conflicts of Jurisdiction

With the enactment of the revised Stock Exchange Act, several new provisions relating to conflicts of jurisdiction have been introduced resolving, to some extent, the questions that arise when companies are neither subject to Swiss nor to foreign rules (negative conflicts of jurisdiction) or when companies are subject to the laws of both jurisdictions at the same time (positive conflicts of jurisdiction).

First, according to the wording of the newly revised Stock Exchange Act, the provisions of disclosure of substantial acquisition and sale of participations as well as the takeover rules shall not only apply, as hitherto, to Swiss companies, i.e., companies incorporated in Switzerland, but also, as mentioned above, to companies not domiciled in Switzerland whose equity securities are mainly listed

83 Stock Exchange Act, art 32, al 4. Except for companies that have opted out of the mandatory offer requirement, the Stock Exchange Act no longer allows the payment of a control premium.

84 Stock Exchange Act, art 33.

in Switzerland. Second, the applicability of the Swiss takeover bid rules may be relinquished if both Swiss law and a foreign law are simultaneously applicable to a public takeover offer, providing that a) the application of Swiss law would lead to a conflict with the foreign law, and b) the protection provided by the foreign law to the investor is equivalent to that provided by Swiss law. [85]

The new conflict rules in the Stock Exchange Act have brought much needed clarity to the question of the Act's applicability on international situations thereby bringing a long-standing evolution of regulatory practice and supporting scholarly debate to a temporary conclusion.

Until 1999, the leading scholars considered that the Swiss domicile was the decisive criteria to establish territorial application of the Stock Exchange Act. However, in 1999, the Federal Banking Commission (now a part of FINMA) overruled a recommendation, issued by the Takeover Board, and stated that the takeover bid made by the French company LVMH Moët Hennessy Louis Vuitton (LVMH) for the shares of TAG Heuer International SA, a company domiciled in Luxembourg, having shares listed on the SWX Swiss Exchange (now the SIX Swiss Exchange), was subject to the Stock Exchange Act and had, therefore, to comply with its provisions.

Although hitherto the Stock Exchange Act's wording clearly restricted the application of the takeover bid rules to 'Swiss companies', the Federal Banking Commission argued that the Luxembourg company, a mere holding company, was actually managed through its Swiss subsidiary (effective management, presentation of the product as a Swiss product). In so doing, the Federal Banking Commission pierced the corporate veil.

This decision has very much been criticised by the legal doctrine which claimed for a new conflict rule in the Stock Exchange Act resolving the question of its applicability on international situations. The place of the first listing and not the domicile of the company should be the decisive criteria for the application of disclosure and takeover bid rules. Some scholars even suggested applying this principle under the present wording, as far as this is needed for the protection of investors.

In a second case, De Beers Centenary AG asked the Takeover Board to state that the takeover bid on all its 'Centenary Linked Units', i.e., all securities traded on the SWX Swiss Exchange (now the SIX Swiss Exchange), would not fall into the application of the Stock Exchange Act. The Takeover Board issued a recommendation according to which, notwithstanding the Swiss domicile of the target company, the transaction was not considered to be subject to the Stock Exchange Act takeover provisions.

In fact, the target company was only a holding company with practically no activity in Switzerland, whereas the main commercial activities of the group were executed in South Africa. Moreover, the affected securities listed on the SWX

85 Stock Exchange Act, art 22, al 1*bis*.

Swiss Exchange (now the SIX Swiss Exchange) were linked to securities of foreign, in particular South African, companies. This recommendation, however, was issued under the condition that the South African Exchange would recognise its competence and the takeover bid, as well as its result be published in the Swiss media. In this way, the goal of the Stock Exchange Act, i.e., the protection of shareholders of the target company in Switzerland, was fulfilled.

Multilateral Approaches

Substantive Law Solutions

Harmonisation. For many decades, Switzerland has actively participated in the efforts of international harmonisation in the field of securities and banking law. Switzerland is a member of the Basle Committee under the auspices of the Bank for International Settlement (BIS). The Committee released the Basle Capital Accord in 1988 (now amended and again in revision) and the Market Risk Accord in 1995. The new 'Basel III' rules have entered into force as per 1 January 2013.

Furthermore, Switzerland has adhered to the Core Principles of the Basle Committee of 1997 (revised in 2006) for the Surveillance of Banking and Financial Systems. In general, Switzerland is taking up the international principles in its own legislation.

Switzerland is actively engaged in the preparation of harmonisation principles in the securities markets under the auspices of the International Organisation of Securities Commissions (IOSCO); the respective guidelines concern the trading of securities and the establishment of collective investment schemes being transferred into the national legislation.

Switzerland is a member of the Financial Action Task Force on Money Laundering (FATF); having a substantial finance and banking market, Switzerland has a major interest in avoiding money laundering and criminal activities in capital markets.

Under the GATS, each World Trade Organisation (WTO) member state, such as Switzerland, is required to accord most-favoured-nation treatment to services and service suppliers of other WTO members. The GATS specifically applies to financial services. Moreover, the member states of the WTO have negotiated additional protocols to GATS in respect of the financial services; the key document is the Fifth Protocol on Financial Services of 12 December 1997, together with the annexed Schedules of Specific Commitments and Exemption Lists, brought into force in Switzerland on 1 March 1999. Switzerland has signed the Fifth Protocol and adjusted, to the extent necessary, its internal legislation.

Previous policies, applying the approach of measured reciprocity and thereby introducing limited access to home markets for foreign financial products and financial institutions, have now been overruled by the Fifth Protocol; apart from specific restrictions on trading services, the reciprocal approach has lost its importance.

Recognition. According to article 37 of the Stock Exchange Act, authorisation of a foreign stock exchange or of a stock exchange controlled by foreign persons

may be refused if the countries in which the foreign stock exchange has its registered office, or the controlling foreign persons are domiciled, do not provide Swiss stock exchanges genuine access to their markets and do not offer them the same competitive opportunities as they do to the local stock exchanges.

This reciprocity requirement is not anymore applied in respect of enterprises originating in countries being members of the WTO and having ratified the Fifth Protocol on Financial Services. With regard to other countries, the practical application by FINMA is quite liberal.

The same rules also apply in respect of the authorisation and supervision of securities dealers. However, since Switzerland is not a member state of the European Union (EU), the single passport principle does not directly apply; therefore, the administrative application must be made by a foreign enterprise.

Procedural Solutions

FINMA is actively engaged in administrative legal assistance related to supervisory authorities in other countries.[86] In particular, publicly inaccessible information and documents can be delivered to foreign supervisory authorities under certain conditions.

The Federal Court usually dismisses complaints against administrative legal assistance in the light of the necessity that supervisory authorities need to get a crossborder view of international financial conglomerates.

86 Stock Exchange Act, arts 38 and 38a.

Taiwan

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Taiwan

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Introduction

In General

During the 1950s, an extensive over-the-counter market developed in Taiwan.[1] By 1954, more than 60 brokerages were trading shares in state-owned companies issued to landowners whose land had been expropriated by the state to further land reform. In 1962, the Ministry of Economic Affairs set up the Taiwan Stock Exchange (TWSE). After a wave of speculation in sugar and margin trading led to a crash in 1964, Taiwan's Legislature enacted legislation in 1968 that formed the basis for modern securities regulation in Taiwan.

During the 1970s and 1980s, Taiwan industrialized and its export-oriented economy grew an average of nine per cent a year in a pattern that has now been repeated (on a vastly greater scale) in neighboring China. This led to many new listings on the TWSE and a remarkably high rate of participation in the stock market by domestic investors during a period when Taiwan's capital markets were essentially closed to foreign investment. By the end of 1990, Taiwan's 22 million people had opened more than 5 million accounts and were trading up to NT $200 billion in shares a day.

On 10 February 1990, the TAIEX reached 12,495.34 from which it fell to 2,560.47 by 1 October of the same year. During the following 10 years, Taiwan restructured its securities regulation regime to protect investors and to rebuild after the crash of 1990 by attracting foreign investment. As a result, Taiwan's capital markets were gradually opened to foreign investment and growth was driven by the rise of Taiwan's dynamic IT manufacturing industry.

Legal Sources

In General

Taiwan has a complex regulatory system governing the issuance and sale of securities. The official website for securities laws in Taiwan lists more than 1,400 laws and regulations.

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1 Yen-ling Liu has made significant contributions to this chapter.

Securities and Exchange Act

Enacted in 1968, the Securities and Exchange Act regulates issuers of securities and securities trading. The Act has been amended 18 times, most recently in 2012. The Securities and Exchange Act's twin purposes are development of the national economy and investor protection.

The Act comprises eight chapters: General Principals; Offering, Issuing, Private Placement, and Trading of Securities; Securities Firms; Securities Dealers Association; Stock Exchange; Arbitration; Penal Provisions; and Supplementary Provisions. To achieve these purposes, the Act grants the Financial Supervisory Commission under the Executive Yuan powers to regulate and supervise the public offering, issuing, and trading of securities. The Securities and Exchange Act is especially concerned with the regulation of public companies.

The Securities and Exchange Act also authorizes the Financial Supervisory Commission, the TWSE, and the GreTai Securities Market (GTSM) to issue regulations governing the public offering of securities. These regulations cover diverse matters including fundraising, underwriting, shareholder business, internal controls, and disclosure of information.

Company Act

The Securities and Exchange Act expressly provides that the Company Act governs matters not provided for within the Securities and Exchange Act. Under the purview of the Company Act are matters such as the establishment of companies limited by shares and their organization, operation, and winding-down.

Securities Investor and Futures Trader Protection Act

The Securities Investor and Futures Trader Protection Act, which became operative in 2002, establishes and funds the Securities Investor and Futures Investor Protection Center, which has special powers to bring class action securities claims against issuers of securities.

The Center has been active: judgments have been issued in the first instance in 22 of the 76 securities cases filed. Approximately half of these judgments have been favorable to the claimant.

Act for Investment by Foreign Nationals

The Act for Investment By Foreign Nationals governs matters relating to domestic investment by foreign nationals, and the protection, restrictions on, and administration of such investments. As authorized under the Act, the Executive Yuan issued the Regulations Governing Investment in Securities by Overseas Chinese and Foreign Nationals in 1983.

Authorities

In General

Taiwan's securities markets are primarily regulated by the Securities and Futures Bureau under the Executive Yuan's Financial Supervisory Commission. The Central Bank also regulates aspects of the securities market that involve foreign currencies and exchange rates. In addition, the Bureau monitors trading on the centralized securities exchange markets and the over-the-counter market through the TWSE and the GTSM.

This monitoring ensures that security firms that have entered into market participation contracts comply with the regulations and charters of the TWSE and the GTSM in keeping with their contractual obligations. The Taiwan Depository & Clearing Corporation supports the Bureau on custody and clearing operations, while the Taiwan Securities Association assists with supervision of securities firms.

Financial Supervisory Commission

The Legislature created the Financial Supervisory Commission in 2004 as an integrated agency regulating insurance, securities, and other financial services. The Commission has four subordinate bureaus: the Banking Bureau, the Securities and Futures Bureau, the Insurance Bureau, and the Financial Examination Bureau.

The Commission is an independent agency acting directly under the Executive Yuan, Taiwan's highest executive agency. The premier nominates the nine commissioners to four-year terms. The president confirms the premier's nominations.

Securities and Futures Bureau

The Securities and Futures Bureau is responsible for:

- Supervision and regulation of public companies, public offering and issuance of securities, listings, and the trading of securities through securities firms;
- Supervision and regulation of the securities business;
- Supervision and regulation of foreign investment in Taiwan's capital markets;
- Supervision and regulation of the Taiwan Securities Association and related organizations;
- Supervision and regulation of securities investment trust funds and margin transactions;
- Supervision and regulation of the auditing and attesting of financial reports by certified public accountants;
- Protection of investors in securities; and
- Follow-up on and checking of inspection reports of relevant financial institutions.

Taiwan Stock Exchange.

The Taiwan Stock Exchange TWSE is Taiwan's largest and most prestigious exchange with 794 listed companies and market capitalization of approximately US $640 billion at the end of 2012. The TWSE was established as a company limited by shares in 1961 pursuant to the Securities and Exchange Act and related regulations.

Investors open accounts and place orders to buy or sell shares with licensed securities firms in person, over the phone, or online. Securities firms are licensed by the Securities and Futures Bureau to operate as brokers, dealers, or broker-dealers.

Duly licensed securities firms are qualified to enter into a contract with the TWSE to participate in the market. Foreign securities firms cannot become members of the market unless they establish a branch or subsidiary in Taiwan and obtain a securities firm license from the Securities and Futures Bureau.

After receiving orders from investors, the securities firm executes the order electronically on the market. Trading is automated and computerized, and there is no floor trading. In addition to serving as a centralized exchange for the trading of securities, the TWSE sets criteria for listing on the exchange and vets applications by public companies, supervises the disclosure of financial and business information of publicly traded companies, and monitors trades for compliance with trading laws and regulations. The TWSE may employ certain disciplinary measures for violations such as financial penalties, halting trading of a listed security, and modifying how a listed security can be traded or delivered.

GreTai Securities Market

The GreTai Securities Market (GTSM) is a public-interest foundation established in 1994 offering centralized and over-the-counter trading mechanisms. Although "GreTai" is a romanization for the Chinese characters meaning "over-the-counter", like the larger TWSE, the GTSM offers a wide-range of financial products issued and traded through the GTSM. In addition to trading of shares listed on the GTSM, the GTSM also administers trading of shares through the Emerging Market Board (an OTC trading mechanism), and trading of governmental and corporate bonds and derivative products.

Primary duties of the GTSM include the review and registration of shares and derivative products, the supervision and regulation of securities issuers, the management and supervision of the GTSM's member securities firms, the payment settlement operations for securities traded over the counter, and sanctioning securities issuers in the event of a breach. Sanctions include financial penalties, halting trading of a GTSM-listed security, and modifying how a GTSM listed security can be traded or delivered.

Emerging Market Board

The Emerging Market Board was established in 2002 to offer a trading mechanism for the securities of public companies that have not yet been listed on the TWSE or GTSM.

The Emerging Market Board is operated by the GTSM. A substantive review is not required for applications for emerging market board securities registration. In general, a foreign company seeking primary listing on the TWSE or GTSM must have its securities traded on the Emerging Market Board for at least six months, with some exceptions.

Taiwan Depository and Clearing Corporation.

The Taiwan Depository and Clearing Corporation has acted as a central register for all securities listed on the TWSE, the GTSM, and the Emerging Market Board since 1990. The Taiwan Depository and Clearing Corporation's primarily roles include the registration of dematerialized securities, custody of securities, book-entry transfer, and clearing and settlement. The Financial Supervisory Commission also may authorize the Taiwan Depository and Clearing Corporation to conduct review of shareholders services of an issuing company.

Taiwan Securities Association

The Taiwan Securities Association is authorized by the Securities and Futures Bureau, under powers delegated to the Bureau by the Securities and Exchange Act, to draft regulations or self-regulator rules for member firms, including brokering, underwriting, and taking orders to buy and sell foreign securities.

New members also sign a self-governing compact on their admission that requires the members to comply with the Association's self-governing rules and charter including, for example, the Association's charter, self governing compact, regulations for the management of advertisements, and some 70 other sets of regulations. Through the Association, member securities firms are urged to impose discipline upon themselves.

The Association also proactively mediates between its members and investors. When securities members engage in predatory pricing, or disputes over willful poaching of employees arise, the Association will attempt to mediate or transfer the matter to the appropriate committee board for an initial ruling. Based on a review of the internal ruling, the member will be urged to discipline itself or be turned over to the Disciplinary Committee to handle the matter in accordance with the self-governing compact. The Committee then passes its decisions on to the Association's Board of Directors for a final decision. In serious cases, the member can be fined NT $500,000 to NT $10 million.

Legal Order and Regulatory Interests

Admission

Market Participants

Foreign investors are welcomed in the Taiwan securities market. The status of foreign investment in public companies, especially TWSE and GTSM listed companies, counts heavily among the various reference factors that local investors look at to guide their own investment decisions.

Foreign investors were first allowed to directly enter the Taiwan securities market as qualified foreign institutional investors[2] in 1991. Five years later the market was opened more widely to foreign institutional investors in general. In 2003, further deregulation opened the market to the current four categories of foreign investor:

- Offshore foreign institutional investors (FINI);
- Offshore foreign individual investors (FIDI);
- Onshore foreign institutional investors; and
- Onshore overseas Chinese and foreign natural persons.

Taiwan's government recognizes that the ongoing liberalization of foreign investment is an important measure to expedite financial reform and extend the scale and internationalization of Taiwan's securities market.

Securities

National Treatment and Reciprocity

The Financial Supervisory Commission has authority to enter into treaties and agreements with foreign governments or institutions based on the principle of reciprocity. The treaty or agreement may be for the purpose of information exchange, technical cooperation, or investigation assistance.

Article 21-1.2 was promulgated in 2006. Its purpose was to promote international cooperation between financial authorities in Taiwan and in other countries in compliance with the International Organization of Securities Commissions' Multilateral Memorandum of Understanding concerning Consultation, Cooperation and the Exchange of Information (MMoU) requirements for an A-level signatory.

The drafters looked to legislation in Hong Kong and the United Kingdom and added a second paragraph in this article authorizing the regulatory authority to share information with its overseas counterparts regarding institutions, legal persons, organizations, and natural persons.

2 In 1990, qualified foreign institutional investors were limited to foreign banks, insurance companies, and fund management enterprises.

Taiwan's Financial Supervisory Commission has signed a number of memorandums of understanding and exchanges of letters with its counterpart regulatory authorities in foreign governments with a view to improving cooperation on information exchange, technical cooperation, and investigation support. It has signed such documents with close to 30 countries to date.[3]

To support these international efforts, the Commission has the power to compel organizations or persons in Taiwan who have been involved in securities trading to present their books or documents or to explain their involvement to the Commission in cases where an investigation or litigation of securities trading is proceeding in a foreign jurisdiction and the authorities request assistance from the Commission. Failure to comply can result in fines of up to NT $2.4 million that can be imposed repeatedly until compliance is achieved.

Issuer Requirements

In General. Between 2004 and 2011, Taiwan continued to introduce sweeping changes to its system for review of market listings. In 2008, as an inducement to capital raising in Taiwan, Taiwan for the first time allowed primary listings for foreign enterprises on the Taiwan market. A foreign issuer must meet the following eligibility requirements in order to obtain a primary listing on the TWSE:

- There must be an operational track record of three years or longer;
- Company boards must comprise at least five member directors, among which at least two must be independent directors, and at least one of the independent directors must be domiciled in Taiwan;[4]
- There must be paid-in capital or shareholders' equity of NT $600 million or higher, or market capitalization of NT $1.6 billion or higher;
- Cumulative pre-tax income for the most recent three fiscal years must have been NT $250 million or higher, with pre-tax income for the most recent fiscal year of NT $120 million or higher, with no accumulated deficit;
- The number of shareholders of record must be 1,000 or more, and the number of shareholders (excluding insiders of the foreign issuer and juristic persons of which such insiders own over 50 per cent of the shareholding) must be no less

3 These countries include Singapore (1993), the United Kingdom (1993), France (1994), Argentina (1995), Australia (1995), Hong Kong (1996), Kenya (1996), South Africa (1996), Thailand (1996), Brazil (1997), Germany (1997), Malaysia (1997), Rome (1997), Spain (1997), Sweden (1997), Chile (1998), Salvador (2000), South Korea (2006), the Netherlands (2006), Turkey (2006), India (2007), Jordan (2007), the Philippines (2007), Dubai (2008), the United States (2008), and China (2009). Some memorandums of understanding and exchanges of letters have also been signed by Taiwan's Ministry of Justice for anti-money-laundering purposes.

4 A foreign issuer must additionally establish either an audit committee or a supervisor. The audit committee must be chosen from among the full number of directors, and must comprise no less than three persons. Foreign issuers also must establish a compensation committee.

than 500, and their total shareholdings must constitute 20 per cent or more of the total issued shares or not less than 10 million shares;

- The number of shares planned to be listed and traded must exceed 50 per cent of the total number of the applicant company's issued shares;
- When applying for a primary listing on the TWSE, the issuer must first receive advisory guidance from the lead underwriter, or register its stock as emerging stock for trading through the GTSM, for a period of at least six months; and
- The applicant company must be recommended in writing by two or more securities underwriters.

Under the current Act Governing Relations between the People of the Taiwan Area and the Mainland Area, foreign issuers applying for a primary listing may not include companies established under the law of the PRC; a foreign issuer in which more than a 30 per cent equity stake is either directly or indirectly held by a PRC entity; a foreign issuer in which a PRC entity or entities have a controlling influence in management; or a foreign issuer with investment in China exceeding a certain ratio of its net worth.[5]

Different standards and eligibility requirements apply in cases of foreign issuers that are part of special industries, including technical companies and construction businesses, as described below.

Technical Companies. A "technical company"[6] is defined as a company so designated by the Industrial Development Bureau, Ministry of Economic Affairs, or a TWSE-designated professional institution, indicating that the company is a technology enterprise and has successfully developed products or technology and those products or technology are moreover marketable. If the foreign applicant company or a company controlled by it that accounts for 50 per cent of its overall operating revenue is a technical company, the following looser requirements will apply:

- At the time of application for listing, the applicant company or the subordinate technical company must have had a record of operation for one full fiscal year or more;
- The company must have paid-in capital of NT $300 million or more, or market value of NT $800 million or more;
- The net worth on the most current financial report audited and attested by a certified public accountant may not be lower than two-thirds of the capital stock, with proof that the company has operating capital sufficient for 12 months of operation following the listing; and

5 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, art 28-1.

6 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, art 28-1.2.

- The number of shareholders of record must be 500 or more, and the total shareholdings of the shareholders of record (excluding insiders of the foreign issuer and juristic persons of which such insiders own more than 50 per cent of the shareholding) must constitute 20 per cent or more of the total issued shares or not less than 5 million shares.

An example of a company in this category would be a biotechnology company that has already received approval from the regulatory authority to undertake human clinical trials or field trials, and has already manufactured and sold biotechnology or medical or health-care products or has provided related technical services.

The procedures to be followed are given in the Ministry of Economic Affairs Industrial Development Bureau's Directions for Contracted Provision of Assessment Opinions Regarding the Successful Development and Marketability of Products Under Application by Technology Enterprises.

Construction Businesses. The issuer requirements are rather stricter if the company applying for listing is a Taiwan construction company.[7] And a foreign issuer that is a construction company (meaning that 20 per cent or more of its operating revenue during the preceding two fiscal years was derived from construction business, or that 20 per cent or more of its gross profits during the preceding two fiscal years were derived from construction business) must meet the same standards.

For example, the company must have been established for at least eight full fiscal years. In addition, its net worth before distribution of earnings in its most recent financial report and for the most recent fiscal year must be 30 per cent or more of the total value of its assets.

Taiwan Depositary Receipts and Secondary Listings. A foreign issuer that wishes to apply to issue Taiwan Depositary Receipts (TDRs)[8] in Taiwan or obtain a secondary listing[9] for its shares on the TWSE must meet the following eligibility requirements:

- The foreign stock must be already been listed on the main board of a stock exchange or securities market approved by the Financial Supervisory Commission;
- The listing must be for 20 million units of TDRs (or shares) or more, or market value of NT $300 million or more; provided that the listed units may not exceed 50 per cent of the total number of shares issued by the foreign issuer;

7 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, art 28-1.3.

8 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, art 26.

9 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, art 27.

- The shareholders' equity stated on the financial report audited and attested by a certified public accountant for the most recent period may not be less than the equivalent of NT $600 million;
- The number of holders of the TDRs or shares in Taiwan must reach at least 1,000 persons, and the total number of units held by the holders (excluding insiders of the foreign issuer and juristic persons of which such insiders own over 50 per cent of the shareholding) must reach 20 per cent of the total units issued, or 10 million units or more;
- The applicant company may not have had accumulated deficit in the most recent fiscal year and must meet one of the following criteria:
- The pre-tax income for the most recent two years must represent not less than six per cent of the shareholders' equity;
- The ratio of pre-tax income to shareholders' equity in the final accounting for each of the past two fiscal years must be three per cent or higher, or the average must be at least three per cent, and the profitability in the most recent fiscal year must be better year-on-year than in the preceding year; and
- The income before tax for each of the most recent two years must be NT $250 million or more.

Bonds. In general, only a primary or secondary (TWSE or GTSM) listed foreign issuer may offer and issue bonds (including straight corporate bonds, convertible bonds, or corporate bonds with warrants), with certain exceptions. The exceptions include, for example, a foreign issuer of Emerging Board stock who files to offer and issue straight corporate bonds denominated in New Taiwan Dollars. A foreign issuer applying to issue bonds must obtain a credit rating from a bond rating institution recognized by the Financial Supervisory Commission indicating that its credit worthiness meets a specific required rating. Nonetheless, for issues of convertible bonds or corporate bonds with warrants, the issuer may be exempted from the credit-rating requirement if all the following conditions are met:

- For secured corporate bonds, convertible corporate bonds, or corporate bonds with warrants, the total amount of those bonds issued may not exceed 200 per cent of the foreign issuer's total assets less total liabilities; and
- The foreign issuer may not issue unsecured corporate bonds under any of the following circumstances: (a) the issuer has done any act in breach of contract, or has been in default of payment of principal or interest, in respect of previously issued corporate bonds or other debts, even if the debt is now settled or (b) the issuer's average annual net profit, after tax, for the most recent three years or, if the issuer has been in operation for less than three years, for the years the issuer has been in operation, does not reach 150 per cent of the total amount of interest payable on the corporate bonds intended to be issued.

A foreign issuer applicant may not issue corporate bonds if the issuer has done any act in breach of contract, or has been in default of payment of principal or interest, in respect of previously issued corporate bonds or other debts, and this circumstance still exists or the issuer's average annual net profit, after tax, for the most recent three years or, if the issuer has been in operation for less than three years, for the years the issuer has been in operation, does not reach 100 per cent of the total amount of interest payable on the corporate bonds intended to be issued; however, corporate bonds issued under a bank guarantee will not be restricted by this.

GTSM Listing. The requirements for primary and secondary GTSM listings (including GTSM listings of TDRs) are similar to, but generally somewhat lighter than, those for primary and secondary TWSE listings.

Securities Requirements

Foreign issuers seeking to raise funds in the Taiwan securities market for corporate finance purposes do so primarily through TDRs, shares, and bonds. The following restrictions apply to TDRs:

- There must be no restriction on the transfer of stock, or securities representing stock, represented by the TDRs;
- The rights and obligations of the holders of stock, or securities representing stock, represented by the TDRs must be identical with those of other stock, or securities representing stock, of the same class issued at the same time.
- The TDRs must be issued in uncertificated (dematerialized) form unless the laws or regulations of the applicant company's country of registration contain a provision to the contrary, and the TDRs must be registered with the Taiwan Depositary and Clearing Corporation; and
- There must have been no abnormal fluctuation in the price of the stock represented by the TDRs during the three months immediately prior to the approval of the listing agreement for TDRs. [10]

Shares must be issued in uncertificated (dematerialized) form unless the laws or regulations of the applicant company's country provide otherwise, and must be registered with the Taiwan Depository and Clearing Corporation. If the laws require physical share certificates, the share certificates must be delivered to the central securities depository. The following types of bonds may be issued in Taiwan:

- Government bonds issued by foreign governments and bonds issued by international organizations;[11]

10 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, arts 2-1, and 26.

11 Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, art 25.

- Straight corporate bonds; and
- Convertible bonds and bonds with warrants.[12]

Prospectus Requirements

Like domestic issuers, a foreign issuer must compile a prospectus before securities may be issued. A TWSE or GTSM primary listed company that offers and issues stock must prepare a prospectus. The content must:[13]

- Comply, *mutatis mutandis*, with the Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses (ie, comply with the same prospectus requirements as for domestic securities); and
- Comply with the Regulations Governing the Offering and Issuance of Securities by Foreign Issuers.

According to the Regulations Governing Information to Be Published in Public Offering and Issuance Prospectuses, a prospectus must include:

- A brief description of the company, its risks, company organization (including compensation status and relationship between the compensation and operational performance of the company's directors, supervisors, general manager, and vice general managers), capital and shares, status of issue of corporate bonds, preferred shares, overseas depositary receipts, employee stock warrants, mergers and acquisitions, and assignments of shares of other companies.
- A description of the operation of the company (including legal compliance regarding environmental protection, e.g., permits for installing anti-pollution facilities or any pollution dispute), fixed assets, real property, other companies that it has invested in, important contracts, and any other items required to be described or supplemented;
- Analysis of the fund utilization plan for any previous cash capital increase, merger or acquisition, assignment of another company's shares, or issue of corporate bonds; analysis of the fund application plan for the current cash capital increase or issue of corporate bonds; and status of any current issue of new shares in connection with assignment of another company's shares, or current issue of new shares in connection with a merger or acquisition;
- A summary financial data for the most recent five years, financial statements, a financial summary, as well as review and analysis of financial condition and operating results;

12 Bonds can be denominated in New Taiwan Dollars or in foreign currencies with the exception of the Chinese Yuan. On 1 January 2012, Taiwan ended its requirement that the par value of foreign shares issued in Taiwan be NT $10 per share. This means that foreign securities can be issued without a par value or with a par value other than NT $10 per share.

13 Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, art 17.2.

- Information on the state of corporate governance; and
- Information on important board and shareholder resolutions in relation to the offering and issuance.

If the foreign issuer is a regulated financial venture such as a bank, bill financer, securities firm, futures house, insurance company, financial holding company, or investment trust, it also must comply with any additional applicable rules in the preparation of its prospectus. In addition to meeting the requirements for prospectuses compiled by domestic issuers, a foreign issuer's prospectus must comply with or include:

- A prospectus prepared in the Chinese language or a Chinese-English bilingual format, provided that, if the English-Chinese bilingual format is used and there is any discrepancy in meaning, the Chinese version will prevail;
- A company introduction and the structure of the group;
- An explanation of any material differences between the rules of the foreign jurisdiction and Taiwan regarding the protection of shareholder equity;
- The consolidated financial statements audited and attested by a certified public accountant, and the audit report, for the most recent two fiscal years as of the time of the filing for the offering and issuance of stock.[14]

A TWSE or GTSM primary listed company or emerging stock company offering and issuing stock must deliver the prospectus to subscribers in advance.

A prospectus for the offering and issuance of TWSE or GTSM secondary listed securities or TDRs[15] must be prepared in accordance with the laws and regulations of the foreign issuer's country of registration and the country where its securities are listed. The prospectus also must be prepared in accordance with the Regulations Governing the Offering and Issuance of Securities by Foreign Issuers. Its content must specify:

- Any matters requiring attention in connection with restrictions, if any, on securities transactions by foreigner nationals, tax burdens, and tax payment procedures, of the foreign issuer's country of registration and country in which its shares are listed;
- The highest, lowest, and average market price of the foreign stock (or original stock represented by TDRs) for the most recent six months on any securities trading market on which it is listed;

14 If the filing date falls more than 75 days after the end of the business half-year, the consolidated financial statement for the first half-year reviewed by a certified public accountant, and the review report, must additionally be submitted. If, before the printing of the prospectus, there is any more recent financial statement audited by a certified public accountant, it also must be disclosed. Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, art 17.

15 Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, arts 22 and 34.

- The method for exercise of shareholder rights; and
- A company overview, operation overview, issuance plan and implementation status, and financial overview, with the disclosure requirements somewhat lighter for a secondary listed issuer than those for a primary listed issuer.

A prospectus also must be delivered to the offerees in advance for any issue of TWSE or GTSM secondary listed shares or TDRs.[16] A prospectus also must be prepared for any offering and issue of corporate bonds.[17] The prospectus must comply with the laws of the foreign issuer's country of registration or the country where its shares are listed, and must include the following specifics:

- Offering plan;
- Concluding opinion of the evaluation report of the securities underwriter (not applicable in the case of an issue of straight corporate bonds);
- Credit rating certificate issued by a credit rating institution;
- Other outstanding bonds;
- Trustee agreement;
- Agency agreement for payment, conversion, or subscription;
- Letter of creation of security interest or provision of guarantee (if any);
- Any matters requiring attention in connection with restrictions on securities transactions by foreign nationals, tax burdens, and tax payment procedures, of the foreign issuer's country of registration and country in which its shares are listed;
- Highest, lowest, and average market prices for the most recent six months of the securities that are issuable upon the conversion of convertible bonds or upon the exercise of warrants attached to corporate bonds, on the stock exchange where the issuer's stocks are listed; and
- Other important matters agreed upon by the parties or that the Financial Supervisory Commission requires.

The content of the prospectus must be detailed, truthful, clear and unambiguous, easy to understand, and free of false information and omissions.[18] Should there be any violation, the issuer, its responsible persons, underwriters, and any officers, certified pubic accounts, lawyers, engineers, and any other professionals or technical persons who sign the prospectus to confirm part or all of the content will be subject to criminal liability of up to seven years'

16 Securities and Exchange Act, arts 25, 34, and 50; Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, art 31.

17 Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, art 50.

18 Securities and Exchange Act, art 2 and Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses, art 32.

imprisonment[19] and civil liability to compensate any damage sustained by *bona fide* trading counterparties.

Corporate Governance

In General. The TWSE and the GTSM have jointly issued the Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies to guide companies listed on those markets in establishing their corporate governance systems.

Important principles include those on internal controls,[20] shareholder rights and interests and their involvement in corporate governance,[21] corporate governance with respect to an affiliate business,[22] improvement of board function (including board structure, election, independent directors, subordinate board committees, including the audit committee and compensation committee, board resolutions, loyalty, and fiduciary duties),[23] interested persons, and information disclosure. Companies listed on the TWSE or GTSM also must include a corporate governance report in their annual reports.[24] The corporate governance report must detail compliance with the principles listed above.[25]

In 1998, Taiwan established internal controls for public companies based on the "COSO Report Internal Control-Integrated Framework", issued by the Treadway Commission. The system has been amended several times, and is now detailed in the Regulations Governing Establishment of Internal Control Systems by Public Companies.

Internal Controls for Primary TWSE and Primary GTSM Listed Companies. Foreign issuers in Taiwan must have the following internal controls:

- Internal controls that comply with the requirements of the jurisdiction in which the issuer is registered; and

19 Securities and Exchange Act, art 174.
20 Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies, art 3.
21 Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies, ch 2, arts 4–13.
22 Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies, ch 3, arts 14–19.
23 Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies, ch 4, arts 20–43.
24 Regulations Governing Information to be Published in Annual Reports of Public Companies, art 7.
25 Regulations Governing Information to be Published in Annual Reports of Public Companies, art 10.

- Internal controls that comply with Taiwan's Regulations Governing Establishment of Internal Control Systems by Public Companies, ie, meet the same requirements applicable to a domestic issuer.[26]

If a foreign issuer listing in Taiwan cannot comply with Taiwan's Regulations Governing Establishment of Internal Control Systems by Public Companies, the TWSE can require the foreign issuer to provide the original statutory context precluding its compliance, a Chinese translation, and a professional opinion by a lawyer or other legal expert.[27] Nonetheless, Taiwan's Regulations Governing Establishment of Internal Control Systems by Public Companies have been relaxed in certain respects for foreign issuers. For example, the required qualifications for internal auditors and continuous training requirements do not apply to foreign issuers. Issuers with secondary listings in Taiwan or TDRs must include details of corporate governance in the prospectus before issuance.[28]

Registration of Public Offerings

With the exception of government bonds or other securities exempted by the Financial Supervisory Commission, any public offering or issue of securities without an effective registration with the Financial Supervisory Commission is prohibited.[29] Once all required documents have been filed, registration of a security normally takes 12 business days. The effective registration period can be shortened to seven business days if the foreign issuer falls into one of the cases listed below:

- A public offering and issue of straight corporate bonds, or issue by a primary TWSE or GTSM listed company or emerging stock company of employee stock warrants;
- A foreign issuer that has already duly issued stock and files, through the TWSE or GTSM, a primary listing contract with the Financial Supervisory Commission for its stock, and subsequently conducts a public sale of new shares issued to effect a cash capital increase before the initial TWSE or GTSM listing;
- A foreign issuer that files, through the TWSE or GTSM, a listing contract with the Financial Supervisory Commission for its sponsored issue of Taiwan depositary receipts, and subsequently conducts a public sale of Taiwan depositary receipts before the initial TWSE or GTSM listing;
- A company with a secondary listing on the TWSE or GTSM that makes a domestic seasoned offering of stock or sponsored issue of Taiwan depositary

26 Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Issuers, art 7.

27 Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Issuers, art 12.

28 Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, arts 25 and 34.

29 Securities Exchange Act, art 22.1.

receipts using shares that have already been issued and are held by shareholders;

- A case of an emerging stock company issuing new shares for a cash capital increase without conducting a public issue; and
- A foreign issuer that has obtained, within the most recent year, a credit rating report of a certain rating or higher from a credit rating institution approved or recognized by the Financial Supervisory Commission for domestically offered and issued securities.

Registration of Private Placements

The term "private placement" under the Securities and Exchange Act means the offering of securities by a public company (which may be a foreign issuer) to specific persons, other than through a public offering, and pursuant to certain statutory requirements. A public company conducting a private placement is merely required to file a recordation of the placement.[30] Nonetheless, a private placement must meet the following requirements:

- A resolution by the board of directors; and
- A shareholder resolution passed by a super majority, where proper prior notice was given to shareholders of the basis and rationale for the setting of the price, the means of selecting the specific persons (where the placees have already been arranged, the relationship between the placees and the company also must be described), and the reasons necessitating the private placement.

For a private placement, the following matters must be periodically disclosed through the online Market Observation Post System (the designated website for required public disclosures of issuer information in Taiwan), including within two days from the board resolution and within 15 days from the time the price of the shares or subscription has been paid up in full. The private placement also must be disclosed in the annual report.

A private placement may not be conducted through general advertisements or public inducements.[31] If this rule is violated, it will be deemed a public offering to the general public. The placees of a private placement must qualify under one of the following categories:

- Banks, bills finance enterprises, trust enterprises, insurance enterprises, securities enterprises, or other juristic persons or institutions approved by the regulatory authority;
- Natural persons, juristic persons, or funds meeting the conditions prescribed by the regulatory authority; and

30 Securities and Exchange Act, arts 14-3, 43-6, and 43-7.
31 Securities and Exchange Act, art 43-7.

- Directors, supervisors, and managerial officers of the company or its affiliated enterprises.[32]

The total number of placees under the latter two categories above may not exceed 35 persons. The resale of securities sold through a private placement also is regulated. Violation of statutory restrictions on a private placement may be subject to criminal liability of up to two years' imprisonment and fines of up to NT $2.4 million.[33]

Disclosure Obligations

Periodic Report

Financial Reports

Annual Financial Report. An annual financial report must be made within three months after the close of each fiscal year. The annual financial report must be publicly announced on the online Market Observation Post System and registered with the Financial Supervisory Commission.

Financial reports must be duly audited and attested by a certified public accountant, approved by the board of directors, and recognized by the supervisors.

First, Second, and Third Quarter Financial Report. Within 45 days after the end of the first, second, and third quarters of each fiscal year, an issuer must publicly announce on the online Market Observation Post System and register with the Financial Supervisory Commission financial reports duly reviewed by a certified public accountant and approved by the board of directors.[34] Corrections to financial reports must be made within the specific time period set by the Financial Supervisory Commission under the following circumstances:

- If the total adjustment to the after-tax profit or loss is equivalent to NT $10 million or more and reaches one per cent of the originally audited operating revenue or five per cent or more of the paid-in capital of the company, the financial reports must be remade and publicly disclosed on the online Market Observation Post System with a statement of the reasons for the correction and the main differences with the original financial report; or
- If the total adjustment to the after-tax profit or loss does not reach the level specified above, the financial report does not need to be remade, but the adjusted sum must be stated in a correction to the amount of the retained earnings.

32 Securities and Exchange Act, art 43-6.
33 Securities and Exchange Act, arts 175 and 178.1.2.
34 Securities and Exchange Act (2012 Amendment), art 36.

Annual Report to Shareholders

The annual report must be distributed to all shareholders[35] prior to or at the annual meeting of shareholders. For securities listed on the TWSE or listed on or traded through the GTSM, copies of the annual report also must be sent respectively to the exchanges and other designated institutions and made available for review by the public.

Operation Status

Within the first 10 days of each calendar month, the issuer must publicly announce and register with the Financial Supervisory Commission the operating status[36] for the preceding month. The operation status report must include the following items:

- The total monetary amount of invoices issued and the total operating income;
- The total monetary amount of endorsements and guarantees provided for third parties; and
- Other items prescribed by the regulator.

Shareholding by Insiders

Upon registering the public issuance of its shares, a company must report the class and numbers of all shares held by its directors, supervisors, managerial officers, and shareholders holding more than 10 per cent of the total shares of the company and report these holdings publicly.

These insiders must report to the issuer each month any changes in the number of shares they held during the preceding month. The issuer must compile these reports and file them with the regulatory authority. If it deems necessary, the authority can order an issuer to announce these changes publicly. If an insider pledges shares, the insider must immediately report the pledge to the issuer. In turn, the issuer must report the pledges to the Financial Supervisory Commission and publicly disclose the pledge on the online Market Observation Post System within five days.

Shareholder Meeting Announcements

Thirty days before a company convenes a regular shareholder meeting or 15 days before a special shareholder meeting, the company must prepare electronic files of the meeting announcement, proxy form, explanatory materials relating to proposals for ratification, matters for deliberation, election or dismissal of directors or supervisors, and other matters on the shareholder meeting agenda, and upload them to the online Market Observation Post System.

35 Securities and Exchange Act, art 36.3.

36 Securities and Exchange Act, art 36.1.4; Securities and Exchange Act Enforcement Rules, r 5.

If voting powers at a shareholder meeting are to be exercised in writing, a print version of the materials referred to in the preceding paragraph and a printed ballot also must be sent to the shareholders.

Internal Control and Internal Auditing

A company preparing for an initial public offering is required to conduct annual self-inspection of the design and operating effectiveness of its internal control systems, and publicly announce and report its Internal Control System Statement on the websites designated by the Financial Supervisory Commission within four months from the end of each fiscal year in the prescribed format.

An Internal Control System Statement and any amendments to it must be approved by a board resolution. An Internal Control System Statement must be published in the company's annual report and in any prospectus.

Immediate Disclosure

Material Information

Material information is any event that has a material impact on shareholders' equity or share prices. Any event involving material information must be publicly announced on the online Market Observation Post System and registered with the Financial Supervisory Commission within two days from the date of occurrence of the event. The following events constitute material information under article 7 of the Securities and Exchange Act Enforcement Rules:

- The dishonoring of a negotiable instrument due to insufficient deposit, refusal to transact by a bank, or other events that result in the loss of good credit standing;
- Any litigation, non-litigious proceeding, administrative disposition, administrative dispute, security procedure, or compulsory execution with a significant impact on the financial status or business of the company;
- A serious drop in the output, complete or partial suspension of work, lease of the company factory or its main facilities, or complete or partial pledge of material assets, with a significant impact on the company business;
- A significant change in operational policies and strategies;
- A judicial decision to prohibit the transfer of the company's shares prior to the company's reorganization granted by a court;
- A change in the chairman of the board, general manager, or more than one-third of the directors of the company;
- A change in the certified public accountant;
- The execution, amendment, termination, or rescission of important contracts, business plans, strategic alliances, new product development, merger or acquisition, or acquisition or assignment of intellectual property rights, with a major effect on the finances or business of the company; and

- Other important events with significant impact on the continuation of company operations.

The TWSE has listed no less than 49 sub-events within the nine categories of material information listed above.

Discrepancies in Financial Reports

An issuer also must publicly report any inconsistencies in annual financial reports approved by the regular shareholder meeting if such reports are inconsistent with the annual financial report that has been announced to the public and filed with the regulatory authority.

Other Specified Events under the Securities and Exchange Act

Any other major financial or operational actions of public companies such as acquisition or disposal of assets, engaging in derivatives trading, provision of monetary loans to others, endorsements or guarantees for others, and disclosure of financial projections also are subject to disclosure requirements under separate regulations.

Disclosure for Foreign Securities

In General

Like Taiwanese securities, foreign securities listed in Taiwan are subject to disclosure requirements, including duties to make public announcements and to register with the regulatory authority.

Periodic Disclosures

Liquidity Status. After the issuance of stocks, a TWSE or GTSM listed company or emerging stock company must within 10 days after the end of each month submit to the Central Bank a report regarding the liquidity status of its stocks issued in Taiwan.

Insider Shareholding Status. Insiders include a listed company's directors, supervisors, corporate officers, and major shareholders (defined as holding at least a 10 per cent equity stake). Insiders also include these persons' immediate family members and their "nominee shareholders". A nominee shareholder is one created by a person who:

- Directly or indirectly provides shares, or a fund to purchase shares, to the nominee;
- Has the power to control, use, or dispose of the shares under the name of the nominee; and
- Is identified as the ultimate beneficiary of the shares.

Any change in insider shareholding requires advance reporting of the change and follow-up reporting of the resulting change in equity holdings (including any pledges). The issuer must report the insider shareholding status on a monthly basis through the online Market Observation Post System. The issuer company is held liable for any damage caused by incorrect or false information in the insider shareholding report.

Financial Statements

In General. Categories of financial report and filing date are:

- An annual financial report, published and filed within four months following the end of each business year;[37] and
- First, second, or third quarter financial reports, published and filed within 45 days following the end of each first, second, or third quarter of the business year.

Audit Requirements. The annual financial report of a public company must be accompanied by an audit and attestation report issued by two domestic certified public accountants. No certified public accountant audit or review is required for the first, second, or third quarter financial report.

The financial reports must be prepared in accordance with the financial reporting standards adopted in Taiwan, the United States, or otherwise in accordance with international financial reporting standards. The accompanying notes included in financial reports must include an indication of the specific accounting principles used, and, if the financial reports are not prepared under the financial reporting standards of Taiwan, a disclosure of any differences between the applied financial reporting standards and Taiwan's financial reporting standards is required.

The financial reports must be prepared using the New Taiwan Dollar (NTD) as the reporting currency. Each financial report, annual report to shareholders, and related materials must be prepared in Chinese, but an English version also may be included. The financial reports must all bear the signatures or seals of the chairperson and managerial and accounting officers. These persons are also required to issue a statement that the financial reports contain no misrepresentations or nondisclosures.

The TWSE may review the financial reports of primary listed companies either substantively or on a *pro forma* basis. If a *pro forma* review by the TWSE reveals that the documentation submitted by a primary listed company is incomplete, or that the certified public accountant audit report contains an opinion other than an unqualified opinion and thus has a significant effect on the financial report of the primary listed company, the TWSE may require the primary listed company to explain specified matters and submit a regulatory

37 Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Issuers, art 4.1.3.

filing of the explanatory matters on the online Market Observation Post System and, where necessary, may require the primary listed company to hold an informational press conference.

The TWSE conducts substantive reviews of foreign issuers selected at random. If any material irregularity is found through a substantive review, the TWSE may require the primary listed company or its auditing certified public accountants or lead underwriter, or agent for litigious and non-litigious matters in Taiwan, or independent director(s) to give explanatory information on specified matters and may, in consideration of the actual situation, require the primary listed company to submit a regulatory filing of the explanatory matters on the online Market Observation Post System. Where necessary, the TWSE may require the primary listed company to hold an informational press conference.

The annual report to shareholders must be transmitted to the Market Observation Post System before the regular shareholder meeting. Two hard copies of the annual report also must be sent to the TWSE 30 days before the meeting. If this is not done, the TWSE can notify the foreign primary listed company to file a hard copy with the TWSE, and publicly disclose the failure by alerting investors of an occurrence of an event with material impact on investor interests.

A foreign primary listed company's internal control system must comply with Taiwan's Regulations Governing Establishment of Internal Control Systems by Public Companies except where the laws of the jurisdiction in which it is registered conflict. In the year in which a foreign company completes its IPO in Taiwan and in the next two accounting years, the company is required to file a review report by a certified public accountant on internal controls when filing its annual report.

By the tenth day of each month, a foreign primary listed company also is required to announce on the online Market Observation Post System and report each previous month's loan balances of its head office and subsidiaries and any endorsements made by itself and its subsidiaries.

Material Information and Press Conferences. When there occurs any material event requiring immediate announcement under the securities laws and regulations of the country where the foreign securities are listed or the rules of the listing securities exchange, the information must simultaneously be input to the online Market Observation Post System. This also applies to any event voluntarily announced by the foreign issuer.

Foreign primary listed companies are required to release material information and hold a press conference in compliance with Taiwan Stock Exchange Corporation procedures.[38] The term "material information" for this purpose

38 Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Issuers, art 16.

generally comports with the statutory definition of the same term in article 7 of the Securities and Exchange Act Enforcement Rules.

A foreign issuer is required to call a press conference when there occurs any of the 25 events defined in Article 2 of the Taiwan Stock Exchange Corporation Procedures for Press Conferences Concerning Material Information of Listed Companies.

Before announcing a press conference regarding material information, a listed company must file a report with the TWSE. The TWSE has the power to order the company to delay a press conference. In general, an explanatory press conference should be held before the trading day next following the occurrence of any event or broadcast media report that triggers the need for a press conference. If a foreign primary listed company is required by foreign law to report sooner in the foreign jurisdiction, it may do so simultaneously in Taiwan. Foreign companies also may send a spokesperson or representative to hold a press conference. Press conferences may not be held as videoconferences. Under some exceptional circumstances, a press conference may be held after material information is released.

Penalties. To ensure the accuracy of and general access to relevant information, a listed company may not externally announce any material information prior to inputting the content of the relevant event into the online Market Observation Post System or holding a press conference concerning material information.

If any of the following circumstances applies to a primary or secondary TWSE or GTSM listed company, the TWSE or GTSM may impose on a case-by-case basis a penalty of NT $30,000. However, if the cumulative number of penalties imposed within the most recent year reaches two or more (inclusive of the current penalty), or if the circumstances in an individual case are due to intent or material negligence, or have a material impact on shareholder equity or securities prices, the TWSE or GTSM may impose a penalty of from NT $50,000 to NT $1 million:

- The primary or secondary listed company violates the regulations regarding verification and disclosure of material information;
- The company arbitrarily publishes unconfirmed news or discloses information that diverges from fact; and
- The company fails to submit relevant sampling check materials as required within the time limit set by the TWSE or GTSM.

The TWSE or GTSM may order the violating company to remake the public disclosure within two business days. If, after receiving notice from the TWSE or the GTSM requiring it to hold a press conference, a listed company still fails to do so and the circumstances of the specific case are serious, the TWSE or the GTSM may alter the method of trading, or suspend trading, of the securities of the listed company.

Acquisition and Disposition of Assets

With respect to the acquisition and disposition of company assets, the primary listed company must comply both with the applicable laws and regulations of the foreign listed company's country of registration, and with the Regulations Governing the Acquisition and Disposal of Assets by Public Companies followed by domestic public companies. A public company is required to formulate procedures for the acquisition or disposal of assets and submit the procedures for approval by the supervisors and the shareholders' meeting. Under any of the following circumstances, any acquisition or disposition of assets must be publicly announced on the online Market Observation Post System and reported within two days from the day of occurrence of the event:

- Acquisition of real property from a related party;
- Investment in the PRC;
- Merger, acquisition, or transfer of shares;
- Losses from derivatives trading reaching the limits on aggregate losses or losses on individual contracts set out in the procedures adopted by the company;
- Asset transaction reaching 20 per cent or more of paid-in capital or NT $300 million, but with certain exclusions (eg, trading of government bonds) allowed by regulations.[39]
- Acquisition or disposal by a public company in the construction business of real property for construction use, where the trading counterparty is not a related party, and the transaction amount is less than NT $500 million; and
- Acquisition of land under an arrangement for commissioned construction on self-owned land, joint construction and allocation of housing units, joint construction and allocation of ownership percentages, or joint construction and separate sale, where the amount the company expects to invest in the transaction is less than NT $500 million.

Any error or omission in information that has been publicly announced and registered is required to be corrected.

Loans and Endorsements

A foreign company whose loans of funds reach one of the following levels must announce and report such event within two days from its occurrence:

- The aggregate balance of loans to others by the company and its subsidiaries reaches 20 per cent or more of the company's net worth as stated in its latest financial statement;

39 Regulations Governing the Acquisition and Disposal of Assets by Public Companies, art 30.

- The balance of loans by the company and its subsidiaries to a single enterprise reaches 10 per cent or more of the company's net worth as stated in its latest financial statement; or
- The amount of new loans of funds by the company or its subsidiaries reaches NT $10 million or more, and reaches two per cent or more of the company's net worth as stated in its latest financial statement.

A foreign company whose loans of endorsement reach one of the following levels must announce and report such event within two days from its occurrence:

- The aggregate balance of endorsements by the company and its subsidiaries for other enterprises reaches 50 per cent or more of the company's net worth as stated in its latest financial statement;
- The balance of endorsements by the company and its subsidiaries for a single enterprise reaches 20 per cent or more of the company's net worth as stated in its latest financial statement;
- The balance of endorsements by the company and its subsidiaries for a single enterprise reaches NT $10 million or more and the aggregate amount of all endorsements for, long-term investment in, and balance of loans to, such enterprise reaches 30 per cent or more of the public company's net worth as stated in its latest financial statement; or
- The amount of new endorsements made by the company or its subsidiaries reaches NT $30 million or more and reaches five per cent or more of the company's net worth as stated in its latest financial statement.

Foreign Issuer's Buyback of Outstanding Securities

When a foreign security is repurchased by its foreign issuer, the buyback information must be published on the online Market Observation Post System and in newspapers.

Trading Rules

Insider Trading

In General

Taiwan's Financial Supervisory Commission is generally quite aggressive about controlling insider trading. The Commission has issued detailed guidelines on what constitutes material information. In addition, the Commission proactively steps in when it discovers suspected insider trading. If it believes that illegal acts have been committed, the Commission will turn the case over to law enforcement agencies for investigation. When an investigation results in facts sufficient to indict, the Prosecutor will bring a criminal action against the offenders.

The Securities and Futures Investors Protection Center also may step in to bring a civil class action on behalf of investors who have suffered losses. Where the

Center prevails in such an action, any damages awarded, less necessary costs paid by the Center, are allocated proportionally to investors. The Center will not charge the investors joining the class action for court fees or any expenses if it loses the case. Since court fees are calculated as a percentage of the claim (usually approximately one per cent for the first instance) and the loser must pay, court fees can be a significant barrier to civil litigation in Taiwan. In years prior to 2004, convictions were rare in cases of suspected insider trading, and sentences were usually less than one year. However, in 2004, the minimum sentence for insider trading was increased to seven years for illegal trading resulting in profits of NT $100 million or more. In line with this legislative change, insider trading also is now dealt with quite severely by the courts in practice.

Insiders

Insiders are defined as:

- A director, supervisor, or managerial officer of the company, or any natural person designated to exercise powers as a representative of the company;
- A shareholder holding more than 10 per cent of the shares of the company;
- A person who learns of material information in the course of employment or because the person controls operations or personnel of the company;
- A person listed above within six months of having left his insider role; and
- A person who learns of material information from a person listed above.

Prohibited Trading

It is prohibited, upon actually knowing of any material information of the issuing company, after the information is precise, and prior to the public disclosure of the information or within 18 hours after its public disclosure, for an insider to purchase or sell, in the person's own name or in the name of another, any shares, equity-type securities or corporate bonds of the company that are listed on an exchange or over-the-counter market.

For equity-type securities (including shares), the term “material information” means any information that will have a material impact on the price of the securities. This includes information such as that relating to the issuer’s finances or businesses, supply and demand of the securities on the market, or a tender offer for the securities, the specific content of which information will have a material impact on the price of the securities, or will have a material impact on the investment decisions of a reasonably prudent investor.

For corporate bonds, the term “material information” means any information that will have a material impact on the ability of the issuing company to pay principal or interest on the bonds.

Material Information

Material information is that which would have a material impact on the price of the securities or on the investment decisions of a reasonably prudent investor.[40]

Civil Liability

Persons in violation of insider trading restrictions will be held liable, to trading counterparts who on the day of the violation undertook the opposite-side trade with *bona fide* intent, for damages in the amount of the difference between the buy or sell price and the average closing price for 10 business days after the date of public disclosure. The court also may, upon the request of the counterpart trading in good faith, treble the damages payable by the violator if the violation is of a severe nature. The court may reduce the damages where the violation is minor.

Any person who acts on information learned from an insider(s) will be held jointly and severally liable for damages along with the insider who provided the information. However, if the insider who provided the information had reasonable cause to believe the information had already been publicly disclosed, that insider will not be liable for damages.

The default rule under the Code of Civil Procedure is that civil proceedings must be brought against a defendant in the place where the defendant is domiciled or resident.[41] However, article 15 of the Code carves out an exception for torts: "In matters relating to torts, an action may be initiated in the court for the location where the tortious act occurred."

Since insider trading is an act that gives rise to a tort claim, a foreign insider who trades on such information on the Taiwan securities markets can be sued in Taiwan even if the insider is not domiciled in Taiwan. If the trade is placed through a Taiwan-registered securities firm and executed on the computers of the TWSE or the GTSM, and the conduct and the resulting losses to investors occur in Taiwan, the Taiwan court will have jurisdiction.

Moreover, Taiwan's courts can exercise jurisdiction over insider trading claims even if the insider trading takes place outside of Taiwan if the trading produces substantial effects on Taiwanese markets or investors, as the Taiwan Supreme Court has held that tortious conduct in article 15 means not only the act itself, but also the resulting injury. The amendments to the Securities and Exchange Act adopted in 2012 also expressly provide that a foreign company that lists in Taiwan, whether as a primary or a secondary listing, is subject to the same regulations and supervision as listed domestic companies. Consequently, Taiwan's civil laws on compensation for damages apply to the shares of foreign companies traded in Taiwan.

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40 Regulations Governing the Scope of Material Information and the Means of its Public Disclosure, art 2; of the Securities and Exchange Act, arts 157-1.5 and 157-1.6.

41 Code of Civil Procedure, art 1.

Criminal Liability

Insider trading is punishable by three to 10 years' imprisonment and fines of from NT $10 million to NT $200 million or greater fines in cases of aggravated insider trading. The Legislature has provided for increased penalties for certain types of aggravated insider trading.

Public Tender Offers

In General

In 1988, the Legislature enacted a new section of the Securities and Exchange Act entitled "Purchase of Securities" and dividing the purchase of securities into market purchase and off-market tender offers. When a purchaser on the TWSE or the GTSM purchases a certain proportion of the shares of a company, the purchaser must report the purchase.

If the purchaser does not purchase the shares on the exchange, the purchaser must follow procedures set up by the Financial Supervisory Commission. These procedures were not issued until 1995 when the regulator at the time released its Regulations Governing Public Tender Offers for Securities of Public Companies.

In general, foreign bidders attempting to take over Taiwanese domestic targets are treated the same as domestic bidders except that they must receive approval for the investment from the Investment Commission under the Ministry of Economics Affairs.

The Investment Commission also acts to protect the interests of Taiwanese investors when it believes that a public tender offer is contrary to those interests. In 2011, for example, the Investment Commission rejected an application to launch a public tender offer for shares in a Taiwan listed technology company because the application came from a joint venture between a private equity fund and the listed company's management team. The investment commission rejected this application because it believed that the private equity fund was too highly leveraged and because the Investment Commission, in consultation with the Financial Supervisory Commission, believed that the offered price lacked transparency. Failure to comply with the requirements relating to public tender offers may give rise to a fine of NT $240,000 to NT $2,400,000. If a juristic person commits the violation, the individual person responsible for the act will be punished.[42]

Normal Public Tender Offers

"Public tender offer" is defined in article 2.1 of the Regulations Governing Public Tender Offers for Securities of Public Companies as a public offer to purchase securities directly from investors, bypassing the TWSE and the GTSM, by a method such as public announcements, letters, electronic media, or the Internet. A securities firm or bank must be retained to deliver the prospectus to

42 Securities and Exchange Act, art 43-1.1.

offerees, to take delivery of the securities, and to make payments to the selling shareholders. The offer must include the number of shares, the price, and the period of the offer.

Before a public tender offer is made, the offeror is required to publicly announce the offer and file forms and documents relating to the offer with the Financial Supervisory Commission. These filings include the Public Tender Offer Report Form and the prospectus. Once the offeror has acquired the number of shares sought, the offeror must publicly announce that the offer has ended and make a regulatory filing with the Financial Supervisory Commission.

Similarly, the offeror must make a public announcement and regulatory filings with the Financial Supervisory Commission within two days following the public offer expires.

If the tender offer set down the condition that the number of shares sold must reach the number of shares intended to be acquired, the announcement must specify whether that condition has been satisfied. A public company whose securities are being acquired through a public tender offer also must disclose:

- The types, number, and amount of shares currently held by the current directors and supervisors and any shareholders with more than 10 per cent of the company's stocks;
- The recommendation made to the company's shareholders on such tender offer purchase, specifying the names and reasons of every dissenting director;
- Whether there have been any major changes in the company's financial conditions after the delivery of its most recent financial statements, and the content of any such changes; and
- The types, number, and amount of shares of the offeror or its affiliated enterprises held by the current directors, supervisors, or the major shareholders having more than 10 per cent of the shareholding of the target company.

An important policy principle that runs throughout this section is that all investors should be treated fairly during takeovers or acquisitions of substantial minority positions. An offeror must adopt uniform acquisition conditions in the public tender offer and may not make any of the following modifications to the acquisition conditions:

- Lower the public tender offer price;
- Lower the proposed number of securities to be acquired through the public tender offer; and
- Shorten the public tender offer period.[43]

43 The length public tender offer period may not be less than 10 days or more than 50 days. The original offeror may report to the Financial Supervisory Commission and

The offeror may not enter into an agreement or covenant with any specific shareholder of the subject company entitling the shareholder to obtain any special rights after the shareholder's participation in the tender through an offer to sell, so that there might exist any discrepancy in the substantial acquisition conditions among shareholders.[44]

If the number of shares to be sold has exceeded the projected number of shares to be acquired, the offeror must purchase the shares *pro rata* from all the tenderers, and return to the original tenderers those shares that have been deposited but not yet transacted.[45]

From the date of filing and public announcement until the date of expiration of the public tender offer period, the public tender offeror and its related parties may not purchase the same class of securities of the public company through the centralized securities exchange, on over-the-counter markets, or any other markets, or by any other means.[46]

Simplified Public Tender Offer

In the following situations, the public tender is less likely to result in a change of management control. Consequently, there is less need to protect investors and the duty to report to the regulator and give public notice is obviated. Nonetheless, the other rules for a public tender offer must be followed:

- The number of securities proposed for public tender offer by the offeror plus the total number of securities of the public company already obtained by the offeror and its related parties do not exceed 5 per cent of the total number of voting shares issued by the public company; and
- The securities purchased by the offeror through the public tender offer are securities of a company of which the offeror holds more than 50 per cent of the issued voting shares.

Mandatory Public Tender Offer

In General

In 2002, the Securities and Exchange Act was amended to add regulations on mandatory public tender offers with reference to United Kingdom law. The purpose of the amendment was to avoid large tender offers that would disrupt the market. The amendments also authorized the regulator to decide the number or percentage of shares to be purchased in mandatory public tender offer cases.

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make a public announcement of an extension public tender offer period. However, the extension period(s) may not exceed a total of 30 days.

44 Securities and Exchange Act, art 43-2; Regulations Governing Public Tender Offers for Securities of Public Companies, art 7-1.

45 Regulations Governing Public Tender Offers for Securities of Public Companies, art 23.

46 Securities and Exchange Act, art 43-3.

If a person independently or jointly with any other persons proposes to acquire a certain percentage of the total issued shares of a public company, the acquisition must be made by means of a public tender offer, unless certain conditions are satisfied.[47]

Article 11 of the Regulations Governing Public Tender Offers for Securities of Public Companies provides that any person who individually or jointly with any other persons intends to acquire within 50 days shares accounting for 20 per cent or more of the total issued shares of a public company must employ a public tender offer to do so.

Although Taiwan considered United Kingdom precedents in making this rule, it also obviously departed from its model. In particular, mandatory public tender offers in Taiwan do not require the purchaser to buy all the shares tendered. But, if the number of shares tendered by all offerees exceeds the number of shares specified in the tender offer, the purchaser must buy from each offeree in proportion to the size of their tender.

Exemptions

There are several exemptions to the mandatory public tender offer rules, including:

- Transfer of shares between affiliates;
- Shares obtained through auction under the Taiwan Stock Exchange Corporation Regulations Governing Auction of Listed Securities by Consignment;
- Shares obtained through on-market tender offer (reverse auction) under the Taiwan Stock Exchange Corporation Rules Governing Purchase of Listed Securities by On-Market Tender Offer or under the GreTai Securities Market Rules Governing Purchase of OTC Securities by On-market Tender Offer;
- Shares obtained from a public company's director, supervisor, manager, or a shareholder holding 10 per cent of outstanding shares under Article 22-2.1.3 of the Securities and Exchange Act; and
- Implementing a share exchange in which new shares are issued to serve as the consideration for acquiring the shares of another public company.

Civil Liability

Duty of Impartiality

A public tender offeror that breaches the duty to offer all investors the same terms is liable for damages to the tenderer up to the amount of the difference between the highest price paid under the public tender offer and the price paid to the tenderer, multiplied by the number of shares purchased.[48]

47 Securities and Exchange Act art, 43-1.3.
48 Securities and Exchange Act art, 43-2.2.

Duty to Acquire Shares Only through Public Offer

A public tender offeror who breaches the duty not to acquire shares during the public offering period by means other than those specified in the public offer (ie, on the market) must be liable to the tendering investors for damages up to the amount of the difference between the price paid for the securities purchased through other means and the price under the public tender offer, multiplied by the number of shares subscribed.[49]

False Information or Omission

A public tender offeror who fails to deliver the prospectus to the tenderer or the prospectus contains false information or omissions in its material contents will be held liable for the compensation of damages sustained by any bona fide counterpart.[50]

Criminal Liability

False Information or Omission

If a public tender offeror make false statements in account books, forms/statements, vouchers, financial reports, or any other business documents as required to be produced for compliance purposes, the public offeror can be fined up to NT $20 million and a sentence of one to seven years can be imposed on the responsible person(s).[51]

Failure to Deliver Prospectus

Failure to deliver a prospectus to the tenderers also is a criminal offense and can be punished by imprisonment for up to one year, detention, and/or a fine of up to NT $1.2 million.

Other Violations

Failure to comply with regulations relating to public tender offers as specified below is punishable by imprisonment for up to two years, detention, and/or a fine of up to NT $1.8 million:

- Failure to report to the Financial Supervisory Commission and make a public announcement as required by regulations prior to the public tender offer;
- Failure to employ a public tender offer if any person independently or jointly with any other persons plans within 50 days to acquire 20 per cent of the total issued shares of a public company; and
- Failure to comply with the orders from the regulator if, to protect the public interest, the regulator orders the public tender offeror to change matters set out

49 Securities and Exchange Act art, 43-3.2.
50 Securities and Exchange Act, art 43-4.3.
51 Securities and Exchange Act, art 175.1.5.

in the public tender announcement and to re-file and re-publish the public notice thereof.[52]

Foreign purchasers employing public tender offers are also subject to applicable civil and criminal liability under Taiwan law. Any form of public announcement, whether by advertisement, radio broadcast, telecommunication, letter, telephone, presentation, explanation, or delivery, is considered to be a public offer if most of the offerees are in the territory of Taiwan.

Conclusion

Taiwan's securities regulations will continue to liberalize and be open to increased internationalization over time. The government regularly refers to the law and practice in other leading jurisdictions in revising Taiwan's laws and regulations.

The pace of this trend, however, has been deliberately moderate, as the regulators want to ensure that the interests of individual investors, and the securities market as a whole, are protected. In light of the recent financial crisis that has swept many securities markets around the world over the past few years, it is unlikely that the pace of liberalization of Taiwan's securities regulations will increase in the short term.

52 Securities and Exchange Act, art 175.

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United Kingdom

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Introduction

The purpose of this chapter is to provide the reader with a view of the regulatory system relating to securities in England. Everything in this chapter relates equally to Wales, and most of what is set out also will apply to Northern Ireland and Scotland, although there are differences which are not dealt with here.

The English regulatory system is undergoing a period of considerable change with the introduction of the Financial Services Authority (FSA) to replace the Securities and Investment Board. The scale of change is apparent from the fact that the Financial Services Authority will take over from the Bank of England responsibility for supervising banks, listed money market institutions, and related clearing houses.

The area covered by this chapter is large. In a sophisticated and developed market which is the English securities market, any subject heading in this chapter could alone be the subject of a book and, indeed, most of them have been. Accordingly, the authors have sought to focus on the principal rules, regulations, and practices relating to them.

The New Regulatory Regime

In General

The draft Financial Services and Markets Bill, introduced into Parliament in June 1999, is a substantial piece of legislation. It sets out a framework for market regulation, leaving much of the detailed substantive provisions to secondary legislation.

The draft Bill will establish a single regulatory regime for all kinds of financial services and a single statutory regulatory, the FSA, to replace the existing financial services regulators, including the self-regulatory organisations.

The draft Bill controls regulated activities. Carrying on any regulated activity without authorisation or exemption will be a criminal offence, and contracts entered into without authorisation or exemption will be unenforceable by the financial services provider.

Once authorised status is granted, a firm will obtain permission to engage in one or more regulated activities. A firm carrying on regulated activities for which it has no permission will be subject to disciplinary action, and it may lose its authorisation.

There is a new regime in the draft Bill for marketing, advertising, and cold-calling. The draft Bill proposes that all kinds of financial preparation be subject to a single regime so that advertising, solicited calls, and unsolicited calls will all be regulated together. It will be a criminal offence for an unauthorised person to issue a communication which contains an invitation or inducement to engage in regulated activities unless that communication is approved by an authorised person.

The draft Bill will broadly continue the regime for recognised investment exchanges and clearing houses under the Financial Services Act 1986, although the FSA's powers under the draft Bill will be widened as compared with those under the current legislation. The FSA will have powers to regulate the Lloyds Insurance market and powers of direction over the Council of Lloyds, although the latter will retain its responsibilities under the Lloyds Act for the superintendents and governors of the society of Lloyds.

The recognised professional bodies regime under the FSA Act 1986 will not continue. The draft Bill gives the FSA a wide range of enforcement powers for breach of its rule.

Steps Taken

Since the government announced its proposals to introduce legislation to reform the regulation of financial services in May 1997, steps have been taken to transfer responsibility for regulation to the FSA.[1]

In other cases, the FSA has entered into contracts with the relevant bodies to perform regulatory functions on their behalf. For example, the Treasury has contracted with the FSA for the performance of certain functions under the Insurance Companies Act 1982. Many relevant staff have become employers of the FSA in the meantime and relocated to the FSA Headquarters. This process of integration will be completed when the Bill is enacted.

United Kingdom Regulatory System

In General

Overview of Financial Services Act 1986

The Financial Services Act 1986 created a new and comprehensive system for the regulation of investment business in the United Kingdom. The Financial Services Act 1986, as amended by the Companies Act 1989, lays down a regulatory scheme by which a person may be permitted to carry on investment business in the United Kingdom. Section 3 of the Financial Services Act 1986 provides that no person may carry on or purport to carry on 'investment business' in the United Kingdom unless he is an 'authorised person' under chapter III or an 'exempted person' under chapter IV of Part 1 of the Financial Services Act 1986. Investments covered by the Financial Services Act 1986 include:

- Shares;
- Debentures;

1 Certain functions under the Banking Act 1987 have been transferred by the Bank of England 1998.

- Government and public securities;
- Instruments entitling the holder to shares or securities;
- Certificates representing securities;
- Units in a collective investment scheme; and
- Options, futures, contracts for difference, long-term insurance contracts, and rights and interests in investments.

Investment business activities include:

- Dealing or arranging deals in investments;
- Managing investments;
- Giving investment advice; and
- Establishing and operating collective investment schemes.

Regulatory Framework

Securities and Investments Board. The Financial Services Act 1986 gives almost all its powers of regulation to HM Treasury and the Secretary of State. Most of the Secretary of State's functions have been transferred to the Securities and Investments Board as his 'designated agency'. The Securities and Investments Board is the overseer of the regulatory structure established under the Financial Services Act 1986 and issues rules on the standards of conduct of investment business, financial supervision, and the protection of client money. The Securities and Investments Board has a status and powers under the Financial Services Act 1986 that make it comparable with the Securities Exchange Commission in the United States.

Securities and Investments Board Principles. The first tier of the Securities and Investments Board's regulation is set out in the Statements of Principle, a broadly worded set of principles concerning the conduct of business and financial standards. They are directly binding on all authorised persons, and they are enforceable only by the self-regulating organisations (see text, below) only, not by the investors. They require an authorised firm to:

- Observe high standards of integrity and fair dealing;
- Act with due skill, care, and diligence;
- Observe high standards of market conduct;
- Seek any information from its customers about the circumstances and investment objectives of such customers that might be relevant in enabling it to fulfil its responsibilities to them;
- Take reasonable steps to give customers comprehensive and timely information;
- Avoid conflicts of interest;
- Arrange proper protection for customers' assets;
- Maintain adequate financial resources to meet its investment business commitments;
- Organise and control its internal affairs in a responsible manner; and

- Deal with its regulator in an open and co-operative manner and keep the regulator promptly informed of anything concerning the firm which might reasonably be expected to be disclosed to the regulator.

Securities and Investments Board Core Rules. The next tier of regulation is the Securities and Investments Board's designated rules (including the Core Conduct of Business Rules and the Client Money Regulations).

Conduct of Business Rules and the Financial Regulations. The third and most complex tier of regulation comprises the conduct of business rules and financial regulations. The Securities and Investments Board has written rules and regulations that apply to directly regulated firms. Broadly, the rules cover the conduct of investment business (eg, the contents of investor agreements, fair dealing, marketing of investments, unsolicited calling, compliance arrangements, and record-keeping). There also are rules covering client money and financial resources requirements. In fixing minimum financial resources requirements, the regulators have divided businesses into different categories, which reflect the risk relating to the particular business activity. The regulations also reflect the minimum capital requirements set out in the European Community (EC) Investment Services Directive.

In addition to maintaining minimum capital requirements, firms must submit regular financial statements to their regulator. These consist of annual audited statements and, depending on the regulator, mid-year, quarterly, and monthly reports. The Securities and Investments Board also has written rules that have general application covering unsolicited calls, cooling-off periods for life assurance policies, and the marketing of unregulated funds.

Securities and Investments Board Register. The Securities and Investments Board maintains a central register that contains details of authorised persons. The register can be accessed by telephone or through Prestel.

Self-Regulating Organisations

In General. As stated above, the Financial Services Act 1986 creates tiers of regulation, and beneath the Securities and Investments Board are a number of self-regulating organisations. The self-regulating organisations consist of the following non-state-funded private companies:

- The Securities and Futures Authority;
- The Personal Investment Authority; and
- The Investment Management Regulatory Organisation.

To become a self-regulating organisation, a company must meet the requirements of Schedule 2 of the Financial Services Act 1986. Broadly, a self-regulating organisation must have rules and practices to ensure that its members will be honest, competent,

solvent, and 'fit and proper' persons to carry on the investment business that it regulates. The following is a summary of the Schedule 2 requirements:

- Fair and reasonable rules for admission and expulsion of members together with disciplinary procedures;
- Rules ensuring an adequate level of investor protection;
- Adequate arrangements and resources to ensure compliance with its rules; and
- Effective arrangements for investigating complaints against its members.

A self-regulating organisation also must promote and maintain high standards of integrity and fair dealing in the carrying on of investment business and be prepared to co-operate with other regulators. Each self-regulating organisation regulates a different area of investment business, although there are some areas of overlap. Although membership of a single self-regulating organisation confers the status of 'authorised person' under the Financial Services Act 1986, each self-regulating organisation has rules prohibiting its members from doing any investment business other than that for which they are regulated by that self-regulating organisation, unless they are members of another self-regulating organisation which regulates that other business (or are directly authorised by the Securities and Investments Board).

Self-regulating organisations operate like members' clubs; the relationship with their members is contractual. Under the contract, each member agrees to comply with the rules of the self-regulating organisations (eg, rules covering conduct of business, client money, and financial arrangements).

Securities and Futures Authority. The Securities and Futures Authority regulates most types of investment business within the meaning of the Financial Services Act 1986. Its regulatory scope includes:

- Dealing, arranging deals, and advising on deals in investments;
- Managing investment accounts and portfolios; and
- Corporate finance activities.

Members of the Securities and Futures Authority typically include banks, securities and derivatives brokers, and clearing firms.

Personal Investment Authority. The Personal Investment Authority is the single regulator of the retail financial sector. It regulates independent intermediaries and the marketing of insurance and pension products by product providers. The types of activity regulated by the Personal Investment Authority include dealing, arranging deals in, managing, and advising on the following types of investments:

- Shares, warrants, and debt instruments (with exceptions, including those that are not readily realisable);
- Units in collective investment schemes;

- Life policies, pensions, and annuity contracts (falling within paragraph 10 of Schedule 1 of the Financial Services Act 1986); and
- Certain derivatives (eg, where used for the purposes of efficiently managing a portfolio of securities).

Investment Management Regulatory Organisation. The Investment Management Regulatory Organisation is principally concerned with the regulation of persons who manage the investments of others. Members typically include investment managers of institutional customers, pension fund managers (and trustees to the extent that the pension fund needs authorisation), and managers and trustees of collective investment schemes (eg, unit trusts). However, those persons who provide discretionary management services to retail customers can join the Personal Investment Authority or, where the investments are options, futures, or contracts for differences, the Securities and Futures Authority.

Recognised Professional Bodies, Investment Exchanges, and Clearing Houses

Certain professional bodies which have been recognised under the Financial Services Act 1986 ('recognised professional bodies') also are involved in the regulatory process. These bodies regulate investment business carried out by their members, thus the Law Society regulates solicitors. The exchanges and clearing houses recognised under the Financial Services Act 1986 are called recognised investment exchanges and recognised clearing houses, both of which also carry out certain regulatory functions.

These include the London Stock Exchange and the United Kingdom futures and options exchanges. The Chicago Mercantile Exchange and NASDAQ are examples of overseas exchanges which are recognised investment exchanges. CREST (the electronic paperless settlement system) is regulated as a recognised clearing house.

Identity of Authorised and Exempted Persons

The following are 'authorised persons' under the Financial Services Act 1986:

- Members of self-regulating organisations;
- Members of a recognised professional body, having an appropriate certificate from it;
- Persons directly authorised by the Securities and Investments Board;
- Insurance companies authorised to do investment business under the Insurance Companies Act 1982;
- Certain operators and trustees of European Union (EU) collective investment schemes;
- Certain persons authorised in the European Economic Area (EEA); and
- Certain persons authorised by the Secretary of State.

The following are the principal exempted persons:

- The Bank of England;
- Recognised investment exchanges;
- Recognised clearing houses;

- Recognised overseas investment exchanges and clearing houses;
- Society of Lloyd's and Lloyd's underwriters;
- Listed wholesale money market institutions; and
- Appointed representatives.

Current Review of Regulatory System

Shortly after the current government assumed office, the Chancellor, Gordon Brown, announced a simplification and reform of the regulatory structure on 20 May 1997. He commented that the division of responsibility between the Securities and Investments Board and the self-regulating organisations was inefficient and confusing and that there was a lack of accountability and clear allocation of responsibilities. The object of the reform was to have a new single regulator. Mr Brown also stated that the responsibility for banking regulation would be moved to the new regulator so that banking regulation would be combined with financial services regulation.

The new single regulator is the Financial Services Authority. The Financial Services Authority, which in corporate and legal terms is the Securities and Investments Board renamed, is a company limited by guarantee. It will acquire its full range of responsibilities in two stages, following the enactment of the necessary two pieces of legislation.

First, the Bank of England Bill will transfer to the Financial Services Authority responsibility for supervising banks, listed money market institutions, and related clearing houses. It was expected that the Financial Services Authority would acquire its new powers to supervise banks in April 1998. Second, the proposed financial regulatory reform Bill will create a new statutory regime under which the Financial Services Authority, in broad terms, will acquire the regulatory and registration functions currently exercised by the self-regulating organisations, the Department of Trade and Industry Insurance Directorate, the Building Societies Commission, the Friendly Societies Commission, and the Registry of Friendly Societies. The Financial Services Authority also will be given responsibility for the authorisation of firms currently authorised to do investment business by virtue of their membership of a recognised professional body. The government has indicated its intention to publish this Bill in draft, for consultation, in the summer of 1998 which might lead to enactment in 1999.

The financial regulatory reform Bill will set out a framework designed to deliver the government's aim of creating a regulator that is clearly accountable to the government and to parliament and that will provide a rationalisation of existing requirements and arrangements. An important element in these arrangements will be the inclusion in the legislation of statutory objectives for the Financial Services Authority in five main areas, namely:

- Sustaining confidence in the United Kingdom financial sector and markets;
- Protecting consumers by ensuring that firms are competent and financially sound and give their customers confidence in their integrity, while recognising consumers' own responsibility for their financial decisions;

- Promoting improvement in public understanding of the benefits and risk associated with financial products;
- Monitoring, detecting, and preventing financial crime; and
- Pursuing its objectives in a way which (a) is efficient and economic and ensures that costs and restrictions on firms are proportionate to the benefits of regulation, (b) facilitates innovation in financial services, and (c) takes account of the international nature of financial regulation and the financial services business.

It is envisaged that the legislation will deal with such matters as the requirements for authorisation to conduct regulated business, sanctions for conducting financial business without the necessary authorisation, and arrangements for firms that are currently authorised.

Foreign Perspective

In General

As a result of United Kingdom regulations implementing the EC Second Banking Co-ordination Directive and the Investment Services Directive, certain European credit institutions and investment firms do not require authorisation under the Financial Services Act 1986, as they have 'passports' conferred by these Directives. European institutions and firms are entitled to such 'passports' where they carry on the activities specified in the Annexes to the Directives in the United Kingdom, either through a branch or on a crossborder basis.

However, a European credit institution or investment firm carrying on such activities in the United Kingdom must comply with the notification procedures set out in the relevant Directive. These procedures involve notifying the firm's home state regulator, which then passes on the notification to the relevant United Kingdom authority, whether or not another exemption or exclusion would have been available to it in respect of those activities. A European institution or investment firm may still need to become an authorised or exempted person under the Financial Services Act 1986 if its activities go beyond those covered by the passport. Thus, it may still be subject to United Kingdom conduct of business and other rules in relation to its United Kingdom investment business.

United Kingdom investment firms also have the benefit of the 'passport' regime for business done by them in other member states of the EEA. United Kingdom-incorporated, authorised, or exempted persons providing 'core investment services' will generally be investment firms under the Investment Services Directive. They will be able to conduct the activities listed in the Annexes to the Investment Services Directive in other member states (via a branch or on a crossborder basis) without being required to obtain a local authorisation, although they may be subject to local conduct of business and other rules. Authorised or exempted persons who conduct listed activities in another member state of the EEA will usually be required to notify the relevant United Kingdom authority before commencing such business.

Under the New Regime

The Financial Services Authority will continue to apply the passporting procedures under the Directives relating to branches of institutions from countries in the EEA. The Financial Services Authority states that it will play an active role in international regulatory co-operation and policy development. It will participate in relevant international regulatory organisations and forums, with a view to enhancing its ability to carry out its functions in the increasingly international environment in which its regulated firms operate. The Financial Services Authority will develop and maintain an economic research capacity covering both the United Kingdom and overseas economies.

The constituent bodies that will make up the Financial Services Authority already have established arrangements for dealing with overseas counterparts on authorisation, supervision, enforcement, and policy matters. The Financial Services Authority will seek to build on and strengthen these arrangements. Work is currently under way to transfer to the Financial Services Authority at the date which it acquires its powers to supervise banks, the memoranda of understanding concerning supervisory matters which the Bank of England has with banking and other authorities around the world. By the time that the Financial Services Authority acquires its full range of powers under the financial regulatory reform Bill, it also will aim to replace the numerous memoranda of understanding and other co-operative arrangements that currently exist between the constituent organisations and their international counterparts with corresponding arrangements.

Legal Sources

In General

The principal market for the listing of securities in the United Kingdom is the London Stock Exchange. The statutory regime governing the listing of securities on the London Stock Exchange has evolved over many years. In particular, it has been altered recently in response to various EC Directives. The relevant EC Directives are:

- The Admissions Directive;
- The Listing Particulars Directive;
- The Interim Reports Directive; and
- The Public Offer Directive.

The first three Directives were implemented by the Financial Securities Act 1986, Part IV, and the Public Offer Directive was implemented by the Public Offer of Securities Regulations 1995. Any public offer of securities on the London Stock Exchange, therefore, is governed by the Public Offer of Securities Regulations, the Financial Services Act 1986, or the Listing Rules which are issued by the London Stock Exchange itself.

If an offer is of investments that are neither listed nor the subject of an application for listing, then it will be governed partly by the Public Offer of Securities Regulations and partly by the Financial Services Act 1986. If an offer is of investments that are listed or are the subject of an application for listing, then it will be governed by the Financial Services

Act 1986 and the Listing Rules. Securities listed on the Alternative Investment Market are subject to the Public Offer of Securities Regulations.

The Regulations require that the offer document or prospectus must be filed with the Registrar of Companies and then published. It must contain sufficient detailed information on the company and its securities to enable a potential investor to make an informed assessment as to whether or not to subscribe for securities in the company.

The three Directives were implemented to ensure minimum requirements throughout the EU, both as to the conditions to be met to obtain a listing on any exchange within any member state and as to the continuing obligations of the issuer following admission. EU member states nevertheless may impose more stringent or additional requirements such that securities may be listed in one member state but still be refused listing in another.

Listing Rules

Each member state is required to nominate an authority that is competent to regulate the admission of securities for listing. For the United Kingdom, this is the London Stock Exchange, and the majority of rules governing listing are found in the Listing Rules of the London Stock Exchange in its capacity as the competent authority. The Listing Rules are given force of law by Part IV of the Financial Services Act 1986, and they are found in the 'Yellow Book' issued by the London Stock Exchange. The guiding principles of the Listing Rules, as set out in the introduction to the Yellow Book, are as follows:

- The London Stock Exchange seeks a balance between providing issuers with ready access to the market for their security and protecting investors;
- Securities will be admitted to listing only if the London Stock Exchange is satisfied that the applicant is suitable and it is appropriate for the security to be publicly held and traded;
- Securities should be brought to the market in a way that is appropriate to their nature and number and will facilitate an open and sufficient market for trading in those securities;
- An issuer must make full and timely disclosure about itself and its listing securities, both at the time of listing and subsequently;
- The Listing Rules, and in particular the continuing obligations therein, should promote investor confidence in the standard of disclosure, the conduct of listed companies' affairs, and in the market as a whole; and
- Shareholders should be given adequate opportunity to consider in advance and vote on major changes in the company's business operations and matters of importance concerning the company's management and constitution.

Public Offer

Schedule 11A of the Financial Services Act 1986, inserted by the Public Offer of Securities Regulations, defines what is meant by an offer of securities to the public in the United Kingdom, and it requires that a prospectus be issued by the issuer of the securities whether or not they are issued on the Official List of the London Stock Exchange or on the Alternative Investment Market.

A prospectus produced outside the United Kingdom will be recognised in the United Kingdom if the document in question is approved by the competent authority of another member state and is to be used in the United Kingdom. Equally, reciprocal arrangements apply to prospectuses produced in the United Kingdom; if approved by the London Stock Exchange, they will be recognised for use in relation to the issue of securities in any other member state.

Legal Order and Regulatory Interests

Market Participants

London Stock Exchange

In General. From its inception, the primary objective of the London Stock Exchange has been to provide facilities for buying, selling, and dealing in securities.[2] It continues to have a pre-eminent role in the equity marketplace, both as a dominant force in the cash market trades of United Kingdom equities and as the leading international exchange for the trading of foreign shares.

> Today's equity market is more sophisticated and diverse than ever before. For any equity risk there are now many different ways of dealing — not only through the traditional cash markets, but through American Depositary Receipts, warrants, convertible bonds, single equity and index futures and options and through contracts for differences. Moreover, investors can often choose where they deal and whether they deal on exchange or over the counter.[3]

Admissions to Listings. The London Stock Exchange has a statutory duty under both the Financial Services Act 1986 and the EC Directives to maintain orderly markets and to require issuers to provide information to ensure the smooth operation of the markets.

As 'competent authority' under the Financial Services Act 1986, the London Stock Exchange has responsibility for admitting to listing those securities ('the Part IV Securities') to its Official List that are covered by Part IV of the Financial Services Act 1986 (as amended by the Public Office of Securities Regulations 1995). The Listing Rules of the London Stock Exchange govern admissions to listing, the continuing obligations of issuers, the enforcement of those obligations, and the suspension and cancellation of the listings. The Financial Services Act 1986 provides that no Part IV Securities can be admitted to the Official List of the London Stock Exchange except in accordance with the provisions of Part IV. This gives statutory authority to the Listing Rules. The Rules reflect:

- Requirements that are mandatory under the EC Directives;
- Additional requirements of the London Stock Exchange under its powers as competent authority in relation to Part IV Securities; and
- Corresponding requirements in relation to other securities admitted to listing.

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2 Deed of Settlement 1875, Clause 2A.

3 Securities Investment Board, 'Regulation of the United Kingdom Equity Markets', *United Kingdom Equity Markets Regulation Reports*.

The London Stock Exchange also may admit to listing certain securities to which Part IV does not apply, principally gilt-edged securities, ie, the government-issued bonds. These admissions are on a non-statutory basis. Part IV does not apply to securities which, rather than being listed, are dealt in on the Alternative Investment Market of the London Stock Exchange or on Trade-Point, or which are listed or quoted on an overseas stock exchange rather than in London. The headquarters of the London Stock Exchange are at the Stock Exchange Building, London, EC2N 1HP. There are trading floors operating in London, Birmingham, Dublin, Glasgow, and Liverpool.

Compliance with Directives. The Council of the London Stock Exchange is the competent authority for the purposes of ensuring compliance with certain EC Directives relating to listed securities.[4]

Representation. All applicants for listing must be represented by a securities house that sponsors the listing and provides the formal link between the company and the London Stock Exchange. The sponsor takes a leading role in presenting the company's case to the Stock Exchange and in arranging for the marketing of shares, underwriting, and sub-underwriting when necessary. It will provide an ongoing service to assist the company in meeting its continuing obligations as outlined in the Listing Rules.

Alternative Investment Market

The Alternative Investment Market is a market operated by the London Stock Exchange designed to serve small, young, and growing companies. It enables businesses to raise capital by gaining access to public finance, even though the company may not be ready to, or wish to, join the London Stock Exchange's Official List.

The company does not need to be a particular size or demonstrate a particular trading history. Nor is it a requirement that a certain percentage of its shares be held by the public. The market, however, is regulated by the London Stock Exchange and, although the process of admission has been simplified, there are conditions that must be satisfied at all times, including a Model Code restricting dealing in the company's shares by directors and employees at certain times.

Other Domestic and Overseas Exchanges

Exchanges

The Financial Services Act 1986 allows any corporate or unincorporated body to apply to the Securities and Investments Board for recognition as an 'investment exchange'.[5] The following are recognised investment exchanges:

- The International Petroleum Exchange;
- The London International Financial Futures and Options Exchange;

4 Stock Exchange Listing Regulations 1984, regs 2(1) and 4(1).
5 Financial Services Act 1986, s 37.

- The London Metals Exchange;
- The London Securities and Derivatives Exchange;
- The London Stock Exchange; and
- Trade-Point Financial Networks PLC, an exchange providing an order-driven dealing service in securities.

Clearing Houses

A clearing house has the function of providing clearing services in respect of transactions effected on an investment exchange. The Securities and Investments Board has recognised the following clearing houses:

- The London Clearing House; and
- CrestCo Ltd.

Overseas Investment Exchanges and Clearing Houses

As stated earlier, overseas investment exchanges and clearing houses may be recognised by the Treasury under the Financial Services Act 1986. The investment exchanges that have been recognised include:

- The Belgian Futures and Options Exchange;
- The Chicago Board of Trade;
- The Chicago Mercantile Exchange;
- Delta Government Options Corp;
- France's MATIF and MONEP;
- Spain's MEFF Renta Fija and MEFF Renta Variable;
- The National Association of Securities Dealers Automated Quotations Inc (NASDAQ);
- The New York Mercantile Exchange;
- The Paris Stock Exchange;
- The Stockholm Stock Exchange; and
- The Sydney Futures Exchange.

Designated Overseas Exchanges

The Securities and Investments Board has a list of 'designated' overseas exchanges that are considered by the Securities and Investments Board to provide protection for investors of an equivalent standard to that of the recognised investment exchanges. Transactions on these exchanges are regarded as if they had taken place on a recognised exchange for the purpose of the Securities and Investments Board Conduct of Business Rules. There are several dozen such exchanges set out in a schedule, which varies from time to time.

Electronic Trading Systems

In General. Electronic information and dealing systems have changed the character and operation of the securities markets to a significant extent.

Stock Exchange Automated Quotations Systems. Stock Exchange Automated Quotations Systems was introduced in October 1986. This established a computerised price quotation system along the same lines as the NASDAQ system in the United States.

Stock Exchange Automated Quotations Systems is not in itself a dealing system, but only an information system. Prices are displayed on a continuously updated basis and transactions are executed by telephone, on the floor of the Exchange, or through the electronic dealing system, CREST.

Stock Exchange Automated Quotations System International. Stock Exchange Automated Quotations Systems International is a screen-based quotation, price collection, and distribution system in non-United Kingdom equity securities which is operated by the London Stock Exchange. Since its inception in June 1985, Stock Exchange Automated Quotations Systems International has grown to be the world's largest market for international securities.

A listing in London is not a requirement for a non-United Kingdom security to be quoted on Stock Exchange Automated Quotations Systems International. However, the majority of the most actively traded stocks on Stock Exchange Automated Quotations Systems International are listed in London, as it is by virtue of listing that a company enters into a continuing direct relationship with the London Stock Exchange. Once listed, the non-United Kingdom company will provide company information to the marketplace through the London Stock Exchange Regulatory News Service.

Stock Exchange Automated Quotations Systems Automatic Execution Facility. The Stock Exchange Automated Quotations Systems Automatic Execution Facility was introduced in 1989. It allows the dealing of small orders in a limited number of shares by means of a computer terminal without having to telephone the market-maker. A stock broker enters the deal on a terminal link with Stock Exchange Automated Quotations Systems, and it is executed at the touch price with the market-maker who is quoting the price.

London Stock Exchange Electronic Trading System. The London Stock Exchange Electronic Trading System is the sometimes referred to as the 'Order Book'. It was introduced on 20 October 1997. It provides an order-driven service for listed securities in *The Financial Times* Stock Exchange 100 Index ('FTSE 100'). It has replaced the quote-driven market system, and it is now the central trading mechanism for those securities. Large transactions (ie, those involving 1,000 or more shares, or at least 500 shares worth more than £5 each) are processed through London Stock Exchange Electronic Trading System.

Orders are entered onto the system with details as to the spread of prices at which the firm is prepared to buy or sell, as the case may be, and the system automatically matches the orders. If there is no match, the order remains on the system until it is either matched or returned to the ordering firm. Reuters, Bloomberg, and ITV provide links to the system for approximately 200 brokers. The securities of listed companies outside the FTSE 100 will continue to be dealt with through the quote-driven system, with market-makers who are obliged to quote two-way prices.

Regulatory News Service. The Regulatory News Service is the London Stock Exchange's mechanism for the receipt and dissemination to the market of regulated announcements provided by companies in accordance with the Listing Rules. The key features of this service for companies are:

- The London Stock Exchange's computer-readable feed, which provides simultaneous dissemination of the full text of announcements to all subscribers to the Regulatory News Service;
- A computerised system to validate the source of announcements; and
- The provision by the London Stock Exchange of telephone confirmation of the release of an announcement.

CREST. 'CREST' is a computerised book-entry settlement system established by CRESTCo under the aegis of the Bank of England which can be extended to gilts and other markets. Book-entry systems work best if the securities are dematerialised (ie, not in paper form), but this is optional for investors, as is joining CREST for quoted companies.

CREST acts as a settlement system for both United Kingdom and Irish securities. It allows members to take advantage of the effective delivery versus payment provided by CREST in sterling and in Irish pounds. From the end of September 1997, CREST has provided a new facility for the settlement of CREST securities (and residuals) in United States dollars.[6]

CREST is proposing to develop links with other European securities depositories to enable participants to hold and settle foreign securities (ie, other than securities of Ireland, the United Kingdom, and the Isle of Man). The introduction of a monetary union in the EU in 1999 is expected to enable participants to increase crossborder activity in securities trading and to heighten the need for efficient cross border facilities for the holding and settlement of securities. CREST has proposals to make it as easy for members to settle foreign securities as domestic securities. Initially, crossborder movements will be on a free-of-payment basis only (although transactions within CREST will be able to use the full range of facilities). CREST is designing crossborder links so that they can also operate on a delivery versus payment basis in the future.[7]

6 CREST, *Settlement of Dollars in CREST* (June,1998).
7 CREST, *Crossborder Settlement* (December 1997).

International Market Association. The International Market Association (ISMA) plans to introduce a 24-hour, electronic, order-driven trading service for international fixed-income securities. The new system, named Coredeal, is expected to be operational at the end of 1998. It will enable international bonds, warrants, and global depository receipts to be traded without the identity of the participants being revealed.

The service will include the advertising and matching of orders and the execution of trades. It also will allow users to negotiate prices and amend the advertised details of the deal and will provide for automatic reporting to TRAX (ISMA's confirmation, risk-management, and regulatory system).[8]

Internet Foreign Exchange Trading Company

Since 1 March 1996, firms providing speculative currency services have had to gain authorisation if their activities fall within the definition of 'investment business' in the Financial Services Act 1986.

As an example, Currency Management Corp is the ninth company to be authorised by the Securities and Futures Authority to provide foreign exchange services. The firm's customers access its Internet site using a personal computer and a modem. The site displays market prices for currencies. together with the price offered by Currency Management Corp. Customers place orders by clicking on the selected Currency Management Corp price.

The firm is not authorised to trade for private investors. Individuals wanting to trade must satisfy the firm that they have the requisite experience and expertise. In addition, a minimum US $20,000 margin deposit is required for opening an account.[9]

Effect of European Monetary Union

London Stock Exchange. The London Stock Exchange has published proposals for trading in the United Kingdom's equity and fixed interest markets under the European Monetary Union. The London Stock Exchange's proposals include:

- A parallel euro order book facility for the most liquid stocks traded on the London Stock Exchange electronic trading service (ie, the London Stock Exchange Electronic Trading System) so that trading can take place in sterling or euros;[10]
- Price quotations on Stock Exchange Automated Quotations Systems International in euros for securities from countries participating in the European Monetary Union; and
- Facilities to trade fixed interest securities in either sterling or euros.[11]

8 ISMA News Release 98/1 (22 January 1998).
9 *The Financial Times* (24 March 1997).
10 All other United Kingdom securities will be quoted in sterling until the United Kingdom enters the European Monetary Union or investors demand changes.
11 London Stock Exchange News Release 2/98 (13 February 1998); London Stock Exchange, *Consultation Paper*: *Economic and Monetary Union — Proposals for the Equity Markets*.

CREST. CREST acts as a settlement system for both United Kingdom and Irish securities. Therefore, it must plan for the introduction of the euro for both a participating country (Ireland) and a non-participating country (the United Kingdom). When the euro becomes legal tender on 1 January 1999, participating countries will lock their conversion rates and enter into a single monetary policy. CREST will be affected in two areas, ie, payments and securities.

CREST already settles against payment in more than one currency (ie, sterling, Irish pounds, and United States dollars), and thus envisages no difficulty. CREST is involved in discussions with the Association for Payment Clearing Services and the Irish Banking Federation on certain technical issues, such as the length of the euro settlement day.

During the three-year transitional period from the start of stage three of the European Monetary Union, issuers in both participating and non-participating countries will be able to choose whether or not to redenominate or renominalise their securities in euros. Redenomination means the exact conversion of a national currency unit into a euro unit. This does not alter the economic fundamentals of a security. Renominalisation means changing a security's nominal value to create a more convenient nominal amount.

Towards the end of 1998, CREST will be able to transform automatically transactions that remain open across a redenomination date where the redenomination itself affects the quantity of units in which securities are transferred.[12]

Off-Market Transactions

Primary and Secondary Markets. There is no requirement for a company to list its shares on the London Stock Exchange to raise funds. Companies can, and do, issue shares directly to the public to raise the finance they require. If a company chooses not to have its shares quoted, then any transactions are private and between individual shareholders at a negotiated price.

Shareholders may subscribe to a company's shares directly through responding to a prospectus. This is called the 'primary' market. The shares that are listed and available on the London Stock Exchange are regarded as the 'secondary' market. In the secondary market, shares are traded on an open but regulated market and the prices may vary throughout the day and from transaction to transaction.

Securities

In General

It is important, for the purposes of this section, to remember the distinctions set out above in relation to 'Admission to Listings'.

12 *CREST Newsletter*, Issue 47 (January 1998).

London Stock Exchange

Conditions Relating to Issuers. Before an issuer will be admitted to listing on the London Stock Exchange, it must comply with the requirements contained in paragraphs 3.2–3.13 of the Listing Rules.

Incorporation. An applicant must be duly incorporated or validly established in its country of incorporation or establishment, and it must be acting within the powers contained in its constitutional documents. A United Kingdom company having limited rather than public status may not be an issuer on the London Stock Exchange.[13]

Accounts. An applicant which is a company must have published or filed independently audited accounts covering at least three years and prepared in accordance with both the applicant's national law and prevailing United Kingdom standards. The London Stock Exchange, on application, may allow for a shorter period.[14]

Nature and Duration of Business. An applicant company must as its main activity be carrying on an independent revenue-generating business, and must have been doing so for the period covered by its accounts.[15]

Management Responsibility. The management of a new applicant company must include persons who have had appropriate responsibility for the company's major businesses during the period covered by the company's accounts.[16]

Directors. The directors of an applicant company must collectively have sufficient expertise to manage its business. The company must ensure that there is no conflict of interest between its directors' private interests and their duties to the company. The company must contact the London Stock Exchange promptly about any potential conflicts of interest.[17]

Working Capital. An issuer preparing listing particulars must include a statement to the effect that it is satisfied that there is sufficient working capital for its present requirements. The London Stock Exchange may not require a working capital statement from a company whose principal business is banking.[18]

Controlling Shareholder. An applicant company must be able at all times to carry on its business independently of any controlling shareholder. A controlling shareholder is one who

13 London Stock Exchange Listing Rules, para 3.2.
14 London Stock Exchange Listing Rules, paras 3.3–3.5.
15 London Stock Exchange Listing Rules, para 3.6.
16 London Stock Exchange Listing Rules, para 3.7.
17 London Stock Exchange Listing Rules, paras 3.8 and 3.9.
18 London Stock Exchange Listing Rules, paras 3.10 and 3.11.

controls either 30 per cent or more of the voting rights at a general meeting of shareholders, or the appointment of directors able to exercise a majority of votes at board meetings.[19]

Conditions Relating to Securities. Securities in a listed company must comply with paragraphs 3.14–3.26 of the Listing Rules.

Validity. Securities must conform with the law of the applicant's place of incorporation, must be authorised under the applicant's constitutional documents, and must have any necessary statutory or other consents.[20]

Transferability. Securities must be freely transferable. Partly paid securities will only fulfil this criterion if the London Stock Exchange is satisfied that their transferability is not restricted and that all relevant information has been given to investors.[21]

Market Capitalisation. The expected total market value must be at least £700,000 for shares and £200,000 for debt securities, or lower if the London Stock Exchange is satisfied that there will be an adequate market for the securities.[22]

Shares in Public Hands. At least 25 per cent of any shares for which an application for admission has been made must be in the hands of the public no later than the time of admission. A lower percentage may be acceptable if there are sufficient numbers of shares in public hands to ensure that the market will continue to operate properly. Listing may be cancelled or suspended where the percentage of shares in public hands falls below 25, or such lower percentage as previously authorised by the London Stock Exchange.[23]

Whole Class to be Listed. An application must be made in respect of all securities of the class to be listed, or all further securities of that class where there are already securities in issue.[24]

Warrants or Options to Subscribe. The issue of warrants or options must not exceed 20 per cent of the issued equity share capital, other than in exceptional circumstances. The conditions for listing are the same as those applying to securities.[25]

Convertible Securities. Convertible securities may be admitted only if the securities into which they are convertible are or will become listed securities or securities on a recognised open market.[26]

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19 London Stock Exchange Listing Rules, paras 3.12 and 3.13.
20 London Stock Exchange Listing Rules, para 3.14.
21 London Stock Exchange Listing Rules, para 3.15.
22 London Stock Exchange Listing Rules, paras 3.16 and 3.17.
23 London Stock Exchange Listing Rules, paras 3.18–3.21.
24 London Stock Exchange Listing Rules, para 3.22.
25 London Stock Exchange Listing Rules, paras 3.23 and 3.24.
26 London Stock Exchange Listing Rules, paras 3.25 and 3.26.

Prospectus Requirements. The information that must be included in the prospectus of a company applying for listing in respect of shares is contained in paragraphs 6A–6G of the Listing Rules.

Persons Responsible for the Prospectus. There must be a declaration by the applicant's directors that they accept responsibility for the contents of the prospectus. The prospectus also must contain the names and addresses of the company's directors, auditors, bankers, legal advisors, and any other experts to whom a statement in the prospectus has been attributed, eg, a statement by the auditors that the company's accounts have been audited.[27]

Shares for Which Application Is Being Made. There must be a statement that an application for listing has been made to the London Stock Exchange and that a copy of the prospectus has been delivered to the Registrar of Companies.[28] The prospectus must give extensive details of the nature and number of shares to be offered, including the rights attaching to the shares, any tax withheld in relation to the shares, and the issue price of the offer.

Issuer and Its Capital. Details must be given of the issuer's incorporation and principal objects, together with full details of its capital composition and any recent changes therein. The prospectus must give details of those persons who exercise control of the issuer and any person interested in 3 per cent or more of the issuer's capital, to the extent that such information is known.[29]

Group's Activities. If the applicant is part of a group, there must be a description of the group's main activities and any significant new developments. There also must be a breakdown of net turnover by category of activity, a description of the group's main investments, and details of the average number of employees.[30]

Issuer's Financial Position. The requirements relating to the issuer's financial position are equivalent to those governing the preparation of the issuer's annual accounts and report. Full and detailed information concerning the issuer's assets and liabilities and profits and losses must be included.[31]

Management. The full name, business address, and function of those people involved in the management of the issuer must be given, together with a description of their other relevant business interests. The aggregate of remuneration paid to directors must be disclosed, as must any directors' interests disclosed to the issuer under the Companies Act 1985.[32]

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27 London Stock Exchange Listing Rules, para 6A.
28 London Stock Exchange Listing Rules, para 6B.
29 London Stock Exchange Listing Rules, para 6C.
30 London Stock Exchange Listing Rules, para 6D.
31 London Stock Exchange Listing Rules, para 6E.
32 London Stock Exchange Listing Rules, para 6F.

Recent Development and Prospects of the Group. General information on the trend of the group's business since the end of the period covered by the last accounts and information on the group's prospects for at least the current financial year must be given.[33]

Alternative Investment Market

In General. The Alternative Investment Market admission rules are contained in the Rules of the London Stock Exchange, which are not to be confused with the Listing Rules, or Yellow Book. In keeping with the reason for the Alternative Investment Market's creation, the requirements governing issuers and securities on the Alternative Investment Market are less complex and demanding than those of the London Stock Exchange, although they do broadly mirror the same underlying principles. The principal rules governing eligibility and admission are outlined below.

Issuer and Securities Requirements. A company wishing to have its securities admitted to the Alternative Investment Market must make a written application that conforms with the requirements of the Public Offer of Securities Regulations and certain additional requirements of the Alternative Investment Market rules. Prior to admission, and at all times thereafter, the following conditions must be satisfied:

- The issuer must be duly incorporated or otherwise validly established;[34]
- The securities must be freely transferable;
- There must be no securities in issue of the class that are admitted to the Alternative Investment Market; and
- The issuer must have both a nominated adviser and a nominated broker, which may be the same firm, whose roles are to ensure compliance by the issuer with its obligations under the Alternative Investment Market Rules and to make a market in the issuer's shares on the Alternative Investment Market.

The issuer's published accounts must conform with its national law and the United Kingdom, United States, or International Accounting Standards. The issuer must ensure that transfers of its securities are registered within 14 days of receipt. The London Stock Exchange may make admission to the Alternative Investment Market subject to any additional special conditions which it deems appropriate for the protection of investors, provided that the applicant is notified of these conditions.

Prospectus Requirements. Where an the Alternative Investment Market or prospective Alternative Investment Market company is issuing shares, the rules governing the form and content of its prospectus are contained in Regulation eight of the Public Offer of Securities Regulations, which states that a prospectus must contain the information

33 London Stock Exchange Listing Rules, para 6G.

34 If it is a United Kingdom company, it must be a public company; otherwise, its relevant law must permit it to issue shares to the public. A public company must have a minimum share capital of £50,000 of which at least one-quarter must be paid up before it can trade.

required in Parts II– X of Schedule 1, which closely mirrors the prospectus requirements of the Listing Rules. The Public Offer of Securities Regulations also impose two further requirements on the content of prospectuses.

Regulation 9. A prospectus must contain 'all such information as investors would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment' of the issuer's financial position and prospects and the rights attaching to the securities.

Regulation 10. Where a prospectus under which securities are still available has been registered pursuant to the Public Offer of Securities Regulations and there is a significant change affecting matters included within it, or there arises a significant new matter that would have had to be included in it, then the offeror must publish a supplementary prospectus containing particulars of the change or new matter. Where there is a significant inaccuracy in a prospectus, this must be corrected by way of a supplementary prospectus.

Non-Listed Companies

Where there is an offer of shares to the public (see text, below, relating to 'Trading Rules') by a company, the Public Offer of Securities Regulations apply, and they must be complied with. The prospectus requirements are as referred to above.

The prospectus must be issued with the authority of an authorised person. Most solicitors authorised to carry on investment business are so authorised. As such prospectuses usually contain financial information by way of cost projections or performance projections, it is customary for a firm of accountants also to be involved.

Transactions Outside the Scope of the Public Offer of Securities Regulations

In certain limited circumstances, shares may be offered without the need to issue a prospectus. The most common of such circumstances are offers of securities to fewer than 50 people or on offer to persons who habitually deal in shares. Such offers are nevertheless still capable, in certain circumstances, of comprising investment advertisements as defined by section 147 of the Financial Services Act 1986.

Investment advertisements also must be approved by an authorised person before dissemination. The process of approval involves verification of the accuracy of facts and statements set out in the investment advertisement.

Corporate Governance

Corporate Governance Committees. Over the past six years, there have been three committees that have issued reports on corporate governance, namely:

- The Committee on the Financial Aspects of Corporate Governance (under the chairmanship of Sir Adrian Cadbury), which reported in 1992;

- The Committee on Directors Remuneration (under the chairmanship of Sir Richard Greenbury), which reported in 1995; and
- The Corporate Governance Committee (under the chairmanship of Sir Ronald Hampel), whose final report was published on 28 January 1998.

Each of the committees was established following scandal and public disquiet about the role of corporations and about aspects of corporate governance. The Cadbury Report followed the somewhat self-indulgent 1980s and the unexpected collapse of several major companies. The Greenbury Committee reported in 1995 on directors' remuneration following considerable public disquiet over large pay increases and large gains by directors of the public utilities that had recently been privatised. The third, under Sir Ronald Hampel, reviewed progress.

Each of these committees was under the chairmanship of acting or former chief executives of large corporations and each made recommendations to fill perceived gaps in the existing statutory framework. None of the three reports had any weight in law; they laid down 'best practice' recommendations which largely reflected the thinking of a number of City institutions.

The reports of the first two committees, however, have been extremely influential, and the indications are that the report of the third also will be. City institutions, to a greater or lesser extent, must have already observed most of the practices contained in the reports. Institutional investors used the recommendations as best practice yardsticks to assess the management of companies. Various business and legal commentators wrote extensively about the reports. The example of the large corporations, the pressures exerted by institutional investors, the generally favourable response of commentators, and the general ripple effect have combined to such an extent that the recommendations might soon be regarded as standard practice, which is a very short step away from law.

Indeed, certain of the recommendations became law through the back door. For example, in the Cadbury Report, a central recommendation was that listed companies should comply with a Code of Good Practice as outlined. Following the Cadbury Report, the London Stock Exchange adopted a Listing Rule requiring listed United Kingdom companies to publish a statement in their annual reports as to the extent of their compliance in the relevant year with the Code and to provide an explanation of any failure to comply.

The London Stock Exchange also made a number of amendments to the Listing Rules in response to the Greenbury Report. For example, listed companies were required to make a statement about the company's compliance with aspects of the Code relating to directors' remuneration, and to furnish an explanation for any deviation.

Cadbury Committee Recommendations. The following are examples of specific recommendations of the Cadbury Committee:

- The board of a company should meet regularly, retain full control over the company, and monitor the executive management;

- There should be a clearly accepted division of responsibilities at the head of a company to ensure a balance of power and authority, such that no one individual has unfettered powers of decision;
- The board should include non-executive directors of sufficient calibre and number for their views to carry weight in the board's decisions;
- Non-executive directors should be appointed for specified periods and re-appointment should not be automatic;
- It is the board's duty to present a balanced and understandable assessment of the company's position; and
- The board should ensure that an objective and professional relationship is maintained with its auditors.

Greenbury Committee Recommendations. The following are examples of specific recommendations of the Greenbury Committee:

- The board should establish a remuneration committee of non-executive directors to determine on their behalf, and on behalf of the shareholders, within agreed terms of reference, the company's policy on remuneration and specific remuneration packages for each of the executive directors, including pension rights and any compensation payments; and
- The remuneration committee should: (a) make a report each year to the shareholders on behalf of the board, (b) provide the packages needed to attract retain and motivate directors of the quality required but should avoid paying more than is necessary, (c) be sensitive to the wider scene, including pay and conditions elsewhere in the company, especially when determining annual salary increases, and (d) take a robust line on payment of compensation where performance has been unsatisfactory and on reducing compensation to reflect a departing director's obligations to mitigate damages by earning money elsewhere.

Present and Future

In General. The law and rules applicable to companies can be found in any of the following:

- A company's own Memorandum and articles of association;
- The Companies Acts 1985 and 1989 and related legislation;
- The Financial Services Act 1986, the Public Offer of Securities Regulations, and the Listing Rules;
- Other legislation in the form of statutes, and statutory instruments, including European legislation;
- Case law;
- Codes of practice; and
- Standards of practice.

The Future. The Green Paper entitled 'Modern Company Law For A Competitive Economy', issued in March 1998 by Margaret Beckett, the President of the Board of Trade, is a Consultation Paper. Margaret Beckett introduces the paper by emphasising the reactive and essentially haphazard approach of twentieth century company law. She points out that the current framework of company law is constructed on foundations that were put in place by the Victorians in the middle of the nineteenth century.

Since then, there have been numerous additions, amendments, and consolidations, leading to layer on layer of sometimes contradictory laws, regulations, rules, and self-regulatory provisions, in a patchwork of a regulatory framework that is immensely complex and seriously unwieldy, particularly for small and medium-sized businesses. The structure became all the more unwieldy following amendments after 1972 as a result of the need to reflect EC Directives.

In 1985, legislation was consolidated in the form of the Companies Act 1985. This was quickly followed by the Insolvency Acts of 1985 and 1986 and by the Financial Services Act 1986. The latter Acts removed insolvency law and securities regulation from companies legislation, and they may be said to represent a major structural change in establishing these areas as distinct areas of law. The Green Paper points out that this may be said to be the only major simplification of companies legislation this century. However, it queries whether or not even this is actually a simplification.

A further Companies Act was passed in 1989. Its main aim was to implement the Seventh Company Law Directive on Consolidated Accounts, and the Eighth Company Law Directive on Audits. There also were certain domestic reforms.

Company Law and Corporate Governance. The Companies Act 1985 and various rules and regulations have much to say about corporate governance. In spite of this, there are many cases in the law reports of disputes that have ended in court as a result of confusion arising about the right way to direct and control companies. Certain of the principles established in these cases have been noted by the legislators and have been taken into legislation, but most remain as case law.

Complexity. Some commentators say that the tension between legislation, the body of case law, and the informal lawmaking by the various committees has become unmanageable. The body of law that governs corporate conduct has been pruned here and stretched there, and has had elements grafted on, to a degree that has made it unrecognisable within the framework of the Companies Act.

For example, commentators refer to 'non-executive directors'. Non-executive directors are well established on boards, and they play a significant role in the direction and control of companies, but there is no reference to a 'non-executive director' in the Companies Acts or other legislation. Indeed, no one can say definitively what exactly a non-executive director is supposed to be or do. Thousands of hours have been spent, and pages written, by committees and others in grappling with this concept. In spite of this, the concept of two kinds of directors (ie, executive and non-executive) within a single board has become the corporate norm.

Commentators also raise the series of recommendations by the committees on disclosure, some of which have become law through the Listing Rules, and others of which have become standard practice. These 'rules' are in addition to, and in some aspects a contradiction of, existing disclosure provisions in the Companies Act.

Reform. The Green Paper concludes that the history of company law since the last century has been a series of additions to the existing legal framework resulting from the need to tackle perceived deficiencies and shortcomings. It goes on to say that the framework has become obsolete and that piecemeal reform cannot significantly reduce the amount and complexity of current arrangements.

Review. Margaret Beckett states that the regulatory structure does not merely require tidying up but is sorely in need of a complete overhaul, particularly if it is to support commerce into the next century. The review is to be a 'thorough and wide ranging review of core company law', and it is to consider the correct structure for regulation so as to 'ensure that we have a framework of company law which is up to date, competitive and designed for the next century, a framework which facilitates enterprise and promotes transparency and fair dealing'.

Timetable. The March 1998 Consultation Paper represents the starting point of the process of review. A Steering Group and Consultative Committee will start work shortly thereafter, and the first Working Group also will start on its task. By March 2001, the final report will be published in conjunction with a White Paper. The resulting legislation will fall to the next parliament.

Periodic Disclosure

Disclosure Obligations

In General. Chapters 9–16 of the Listing Rules impose ongoing obligations on listed companies to disclose information in certain situations. Where such an obligation arises, the company must generally notify the Company Announcements Office of the London Stock Exchange without delay. The relevant Listing Rules themselves are summarised below. However, it is worth noting that, behind these rules, there are just two overriding principles, namely:

- Disclosure of information; and
- Equal treatment for shareholders.

These principles are designed to achieve an orderly market by ensuring that all users of the market have simultaneous access to the same information.[35]

35 Button and Bolton (eds), *A Practitioner's Guide to the London Stock Exchange Yellow Book*, at p 140.

Specific Provisions of Chapter 9 of the Listing Rules. Paragraphs 9.1–9.38 of chapter 9 of the Listing Rules relate to disclosure obligations.

General Obligation of Disclosure for Companies. Under paragraph 9.1 of the Listing Rules, where there is a major development in a company's sphere of activity that is not public knowledge and may substantially affect the price of its listed securities, the company must notify the Company Announcements Office without delay. Under paragraph 9.2, where the directors of a listed company are aware of a change in either a company's financial condition or the performance of its business or the company's expectations of its performance, and where general knowledge of this would be likely to lead to a substantial movement in the price of its listed securities, the company must notify the Company Announcements Office.

The London Stock Exchange may exceptionally release a company from its above obligations where disclosure of such information might prejudice the company's legitimate interests. Where a potential development is still under negotiation, a company may inform certain parties, such as its financial advisers and representatives of its employees, without first informing the Company Announcements Office.[36] The company, however, must be satisfied that any parties so informed know that they must not deal in the company's securities until the information has been made public.

Where a company intends to announce information at a shareholders' meeting that may lead to substantial movement in the price of its listed securities, the company must ensure that such information will be released to the public no later than the time of the meeting.

Notification Relating to Capital. The Company Announcements Office must be informed of any proposed changes to a company's capital structure, including the structure of any listed debt securities.[37] Any change in the rights attached to any class of listed securities and any new issue of debt securities also must be announced, as must the basis of allotment of listed securities offered generally to the public or openly to shareholders. The results of any new issues must likewise be given to the Company Announcements Office.

Notification of Major Interests in Shares. There are certain circumstances in which the Companies Act 1985 obliges a company's shareholders to notify it of their interest in shares of the company. Where such notification is in fact made to the company, the company is required by the Listing Rules to inform the Company Announcements Office of any details received without delay. Companies not subject to the Companies Act 1985 must inform the Company Announcements Office of any equivalent information.[38]

Notification When the Company Announcements Office Is Closed. Where a company is required to disclose information at a time when the Company Announcements Office is

36 London Stock Exchange Listing Rules, para 9.4.
37 London Stock Exchange Listing Rules, para 9.10.
38 London Stock Exchange Listing Rules, paras 9.11–9.14.

closed, it also must disclose the information to at least two national newspapers and two newswire services in the United Kingdom.[39]

Communication with Shareholders. A company must ensure that there are sufficient facilities and information available to enable the holders of its securities to exercise their rights. Thus, the company must inform the holders of its securities of any meetings that they are entitled to attend, and enable them to exercise any right to vote either in person or by proxy.[40]

The company also must publish notices or distribute circulars with information on the distribution of any dividends, the issue of new securities, and the redemption or repayment of securities. Where a company needs to communicate with the holders of bearer shares, it must advertise in at least one national newspaper in each relevant territory.

9.33–9.38 Miscellaneous Obligations. A company must disclose to the Company Announcements Office decisions made by the board of directors concerning dividends, profits, and other matters.[41] Disclosure must be made no later than 8:30 a.m. on the next business day after the decision is made. A company must notify the London Stock Exchange immediately it becomes aware that the percentage of a class of securities in public hands has fallen below 25 or any lower percentage previously agreed by the London Stock Exchange.

Chapter 10 of the Listing Rules. Transactions involving acquisitions and disposals by a listed company are divided into four classes, each with progressively more detailed disclosure requirements. A full explanation of the criteria for establishing the class into which a given transaction may fall is beyond the scope of this chapter.

However, in general, the larger the size of the subject company relative to the company dealing in its securities, the more detailed the disclosure requirements regarding the transaction, and the more involved the process. Larger transactions will require circulars and also must be ratified by shareholders in a general meeting.

Chapter 11 of the Listing Rules. Where a listed company proposes to enter into a transaction with a related party, it must notify the Company Announcements Office of the details of the transaction and send a circular containing full particulars to the shareholders, who must approve the transaction.

For the purposes of chapter 11, a 'related party' is defined as a substantial shareholder or any person who is a director of the company or any subsidiary. Certain parties connected to a related party (eg, the spouse or children of an individual or the subsidiary of a company) are themselves considered related parties.

39 London Stock Exchange Listing Rules, para 9.15.
40 London Stock Exchange Listing Rules, paras 9.24–9.31.
41 London Stock Exchange Listing Rules, paras 9.33–9.38.

Chapter 12 of the Listing Rules. All listed companies are required to issue an annual report and accounts.[42] The following information about the company's financial affairs and its management must be included in accordance with paragraph 12.43 of the Listing Rules (12.43(a) has been deleted):

Commentary on Forecasts. An explanation must be given where the actual results of the company differ by more than 10 per cent from its forecast.[43]

Interest Capitalised. A statement must be provided as to the amount of interest capitalised and the treatment of any tax relief.[44]

Waiver of Emoluments. Details must be given as to any arrangement whereby a director has waived or will waive any emoluments from the company.[45]

Waiver of Dividends. Details must be provided as to any arrangement whereby a shareholder has waived or will waive any dividend.[46]

Non-Executive Directors. The identity and a brief biographical note of each non-executive director must be given.[47]

Financial Aspects of Corporate Governance. In the case of United Kingdom companies, a statement regarding the extent of the company's compliance with the Code of Best Practice must be provided.[48]

Directors' Interests in Shares. In the case of United Kingdom companies, a statement must be given, showing the extent to which any director or any member of a director's family is a shareholder in the company.[49]

Major Interests in Shares. In the case of United Kingdom companies, disclosure of certain major interests must be made.[50]

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42 Listed companies also are required to issue a report on the company's activities and financial affairs for the first six months of each of their financial years. Under paragraphs 12.52–12.59, this report must contain an abbreviated profit-and-loss account, together with any necessary explanatory statements.
43 London Stock Exchange Listing Rules, para 12.43(b).
44 London Stock Exchange Listing Rules, para 12.43(c).
45 London Stock Exchange Listing Rules, para 12.43(d).
46 London Stock Exchange Listing Rules, para 12.43(e).
47 London Stock Exchange Listing Rules, para 12.43(i).
48 London Stock Exchange Listing Rules, para 12.43(j).
49 London Stock Exchange Listing Rules, para 12.43(k).
50 London Stock Exchange Listing Rules, para 12.43(i).

Purchase by Company of Its Own Shares. In the case of a United Kingdom company, details of any shareholders' authority for the company to purchase its own shares must be provided.[51]

Allotments for Cash. Details must be given as to any allotments that are not made in accordance with pre-emption provisions and that have not been specifically authorised by the company's shareholders.[52]

Parent Undertaking Participation in a Placing. Where a company is a subsidiary, details of any participation by its parent company in a placing must be given.[53]

Interest in Contracts. Details of any contract of significance (defined in paragraph 12.44 of the Listing Rules) as a contract involving one per cent or more of a given transaction or annual sales, as appropriate) or any contract to which the company or a subsidiary is party and in which a director is or was materially interested must be given.[54]

Contracts of Significance. Details must be given as to any contract of significance between the company or a subsidiary and a controlling shareholder or any contract of services which are not the controlling shareholder's principal business.[55]

Small Related-Party Transactions. Details relating to small related-party transactions and amendments to any contractual arrangements with a controlling shareholder must be given.[56]

Long-Term Incentive Schemes. Details of any long-term incentive schemes and employees' share schemes must be given.[57]

Going Concern. In the case of United Kingdom companies, a directors' statement that the company is a going concern must be provided.[58]

Directors' Remuneration. In the case of United Kingdom companies, a statement on compliance with the best practice provisions and a report detailing the company's policy on directors' remuneration and all directors' remuneration packages must be given.[59]

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51 London Stock Exchange Listing Rules, para 12.43(n).
52 London Stock Exchange Listing Rules, para 12.43(o).
53 London Stock Exchange Listing Rules, para 12.43(p).
54 London Stock Exchange Listing Rules, para 12.43(q).
55 London Stock Exchange Listing Rules, para 12.43(r) and (s).
56 Stock Exchange Listing Rules, para 12.43(t).
57 London Stock Exchange Listing Rules, para 12.43(u).
58 London Stock Exchange Listing Rules, para 12.43(v).
59 London Stock Exchange Listing Rules, para 12.43(w) and (x).

Chapters 13 and 14 of the Listing Rules. Chapters 13 and 14 set out the London Stock Exchange's requirements for the form and content of certain documents and circulars that the Listing Rules and the Companies Act 1985 require listed companies to publish. Unless such documents and circulars comply with the requirements of these chapters, a detailed description of which is beyond the scope of this chapter, they must first be submitted in draft to the London Stock Exchange for approval.

Chapter 15 of the Listing Rules. A company may not purchase its own securities at any time when its directors or employees are prohibited by the Model Code from dealing in the company's securities (see text, below, relating to chapter 16 of the Listing Rules). Where the board decides to submit to shareholders a proposal that the company be authorised to purchase its own shares, it must notify the Company Announcements Office of this proposal without delay unless it relates simply to the renewal of an existing authority.

Chapter 16 of the Listing Rules. A company is required to disclose certain information about its directors and their dealings in the company's securities. New applicant companies must submit a formal declaration by each of their directors as to their past and present business activities to the Securities and Futures Authority. Declarations in respect of new directors to a listed company also must be submitted, as must updated declarations where appropriate.

A company must notify the Company Announcements Office without delay where there is any change to the membership of the board of directors or where any material functions or responsibilities of a director are changed. It also must notify the Company Announcements Office of any information it receives relating to a director's interest in the company's securities.

Annexed to Chapter 16 is a Model Code, which prescribes the times when and conditions under which the directors and employees of a company may or may not deal in its securities. Under paragraph 16.18 of the Listing Rules, companies must require their directors and employees to comply with the Model Code, which ensures that they do not take unfair advantage of their position within the company to benefit through trading in its securities. In particular, they are prohibited from dealing in the company's securities within two months prior to the publication of its annual results or when they are in possession of unpublished information that may affect the value of the company's securities.

Chapter 17 of the Listing Rules. Overseas companies listed or seeking a listing on the London Stock Exchange must comply with all relevant Listing Rules generally, or as modified by paragraph 17. Certain modifications apply to all such overseas companies, while the application of others will depend on whether the company has (or will have) a 'primary' or 'secondary' listing. A company's 'primary listing' will normally be determined by its country of incorporation or first listing or by the country in which a majority of the securities are held.

Where an overseas company seeking a listing on the London Stock Exchange has been listed in another member state of the EU for not less than three years, the London Stock

Exchange may exempt it from the obligation to publish listing particulars. If this happens, the company will be required to publish certain limited information in an 'exempt listing document' instead of listing particulars. The modifications applicable to all overseas companies are contained in paragraphs 17.2–17.10 of the Listing Rules.

Conditions for Listing. In general, the shares of a company incorporated in a non-EU state must already be listed either in its country of incorporation or in the country in which most of its shares are held.[60] Where the company's accounts have been prepared in a different format to those prescribed by the Listing Rules, the London Stock Exchange may nonetheless accept those accounts if it is satisfied that they have been prepared to an appropriate standard. The company should consult the London Stock Exchange at an early stage to discuss this possibility.

Listing Particulars. Certain documents already prepared by a company pursuant to any public reporting and filing obligations in its country of incorporation (or primary listing) may be incorporated in English translation in its listing particulars.[61] The omission of certain information, as permitted by paragraph 5.18, also may apply to overseas countries.

Half-Yearly Reports. A company incorporated in a non-EU state, with the London Stock Exchange's permission, may publish an English translation of the half-yearly report published in its country of incorporation to comply with its obligations under the Listing Rules.[62]

Pre-Emption Rights. Overseas companies are not required to comply with the requirements regarding pre-emption rights in paragraphs 9.18–9.23 of the Listing Rules.[63]

English Language. All information required by the Listing Rules must be given in English translation.[64]

Overseas Companies with or Seeking Primary Listing. Additional modifications applying only to overseas companies with primary listing are contained in paragraphs 17.11–17.13. These paragraphs essentially reformulate certain Listing Rules that refer to English legislation in terms that are applicable to overseas companies. Particular reference is made to a company's duty to inform the Company Announcements Office of any information received related to directors' interests in the company.

Overseas Companies with or Seeking Secondary Listing. Overseas companies with or seeking secondary listing need not comply with chapters 9, 10, 11, 14, and 15 or the continuing obligations regarding financial information and directors' disclosure.

60 London Stock Exchange Listing Rules, paras 17.2–17.4.
61 London Stock Exchange Listing Rules, paras 17.5 and 17.6.
62 London Stock Exchange Listing Rules, para 17.7.
63 London Stock Exchange Listing Rules, paras 17.8 and 17.9.
64 London Stock Exchange Listing Rules, para 17.10.

However, many of the requirements contained in these chapters are reproduced in a simplified form in paragraphs 17.22–17.67 of the Listing Rules, with which companies with or seeking a secondary listing must comply. Where there is any doubt as to whether an ongoing obligation applies, the London Stock Exchange should be consulted.

Disclosure Rules on the Alternative Investment Market. The disclosure rules on the Alternative Investment Market also are contained in the Rules of the London Stock Exchange. The Alternative Investment Market disclosure rules are essentially a much simplified version of the Listing Rules requirements discussed above.

American Depositary Receipts Disclosure

Global Depositary Receipts and American Depositary Receipts. The development of the global securities market has brought with it a need for investors to be able to deal in securities in currencies with which they are familiar. The United States market response to this in relation to securities in overseas companies was to create the American Depositary Receipt. This is now increasingly used on a global basis in the form of a Global Depositary Receipt to facilitate offerings, particularly in American market securities. A Global Depositary Receipt is a 'bundle' of shares which, because it is not a share itself, can be traded and settled in the international markets without the need to comply with the laws of the country of incorporation of the issuer of the underlying shares.

Global Depositary Receipts are usually represented by a single certificate, known as a Master Global Depositary Receipt Certificate and issued by a bank acting as a depositary of the shares concerned. Each Global Depositary Receipt Certificate represents the relevant number of underlying shares held by the bank on deposit. The Certificate is evidence of ownership of the underlying shares, and each holder may request that they be issued with an individual Global Depositary Receipt representing a specific number of shares. These individuals' Global Depositary Receipts may then be traded as negotiable instruments.

A Global Depositary Receipt is, for all intents and purposes, the same as an American Depositary Receipt. Global Depositary Receipts are recognised in the United States markets as a familiar instrument and, indeed, Global Depositary Receipts are normally denominated in United States dollars and, therefore, enable international investors to hold securities in the currency with which they are familiar and with which they feel secure. Any dividends payable on the underlying shares in local currency are converted into United States dollars at a cost borne by the holder of the Global Depositary Receipt.

The United Kingdom. In relation to the London Stock Exchange, Global Depositary Receipts and American Depositary Receipts are defined as 'specialist certificates representing shares', and they are governed by paragraph 23.45 of the Listing Rules. The issuer of the underlying shares, if an overseas company, also must comply with paragraph 17.19(a) of the Listing Rules.

In the case of specialist certificates representing shares, the issue of the shares is subject only to the continuing obligations set out in paragraphs 23.58–23.87 of the Yellow Book, which are essentially a simplified version of the continuing obligations discussed above. The issuer, if any of its securities are listed on the London Stock Exchange or on any other stock exchange, must ensure that any disclosure of information is made simultaneously to the market at the London Stock Exchange and at each such other stock exchange. In the case of issuers situated or operating in a non-EU state, information equivalent to that notified to the market of the non-member state need only be notified to the Company Announcements Office if such information may be of importance.

Trading Rules

Securities Offerings

Offer. Under section 5 of the Public Offer of Securities Regulations:

> A person is to be regarded as offering securities if, as principal:
>
> (a) he makes an offer which, if accepted, would give rise to a contract for the issue or sale of the securities by him or by another person with whom he has made arrangements for the issue or sale of the securities; or
>
> (b) he invites a person to make such an offer;
>
> but not otherwise; and, except where the context otherwise requires, in this Part of these Regulations, 'offer' and 'offeror' shall be construed accordingly.

Public. Under section 6 of the Public Offer of Securities Regulations:

> A person offers securities to the public in the United Kingdom if, to the extent that the offer is made to persons in the United Kingdom, it is made to the public; and, for this purpose, an offer which is made to any section of the public whether selected as members or debenture holders of a body corporate, or as clients of the person making the offer, or in any other manner, is to be regarded as made to the public.

Under section 7 of the Public Offer of Securities Regulations, 21 situations that would otherwise fall within the somewhat broad ambit of sections 6 and 7 are deemed not to constitute 'offers to the public'. It is beyond the scope of this work to list all 21 such exceptions; however, the following are the most important in the context of listed securities:

- Offers to persons whose ordinary activity involves them in dealing with investments for the purpose of their business, or who would reasonably be expected to deal with investments;[65]
- Offers to 50 or fewer persons;[66]

65 Public Offer of Securities Regulations, s 7(a).
66 Public Offer of Securities Regulations, s 7(b).

- Offers to a restricted circle of persons who the offeror reasonably believes to be sufficiently knowledgeable to understand the risks involved in accepting the offer;[67]
- Offers made in connection with a *bona fide* invitation to enter into an underwriting agreement;[68]
- Offers in connection with a take-over offer;[69] and
- Offers in connection with a merger within the meaning of Directive 78/885/EEC.[70]

Disclosure of Substantial Holdings

Shareholder Duties. Substantial Acquisition Rules are issued by the Panel on Take-Overs and Mergers, the non-statutory body that regulates take-over activity through the application of the City Code. The aim of the Substantial Acquisition Rules is to limit the speed and secrecy with which a shareholder can increase its stake in the company within the stakeholding band ranging from 15 to 30 per cent of the issued share capital. The Substantial Acquisition Rules are only relevant to transactions in shares of companies listed on the London Stock Exchange or the Alternative Investment Market companies resident in the United Kingdom, the Channel Islands, the Isle of Man, and the Republic of Ireland.

Substantial Acquisition Rules, Rule 1. A person may not, in any period of seven days, acquire shares carrying voting rights in a company, or rights over such shares (eg, options), representing 10 per cent or more of the total voting right in that company, if such acquisition would result in an aggregate holding of more than 15 per cent but less than 30 per cent of the total voting rights in that company.

In other words, if a person is about to make an acquisition of shares, then any acquisitions made by them in the previous six days will be taken into account. If the total acquired in that period is less than 10 per cent of the total voting equity, then the acquisition can be made without restriction. If the total acquired is 10 per cent or more of the voting rights and would result in the overall holding by that shareholder falling within the 15 to 30 per cent range, then the acquisition is prohibited unless one of the specific exceptions applies.

Note that, if the acquisition results in a shareholder holding 30 per cent or more of the voting rights, then the Substantial Acquisition Rules do not apply at all. Instead, rule 5 of the City Code becomes relevant and the shareholder must make a mandatory offer for the entire issued share capital of the company in question.

Substantial Acquisition Rules, Rule 2. Rule 2 sets out the exceptions noted in rule 1 of the Substantial Acquisition Rules, which includes an acquisition from a single shareholder if it is the only such acquisition within any period of seven days. It also includes any acquisition immediately before the announcement of an offer, provided that the offer

67 Public Offer of Securities Regulations, s 7(c).
68 Public Offer of Securities Regulations, s 7(d).
69 Public Offer of Securities Regulations, s 7(e).
70 Public Offer of Securities Regulations, s 7(f).

will be recommended or approved by the board of the company and in either case that the acquisition is conditional on the announcement of that offer.

Substantial Acquisition Rules, Rule 3. Rule 3 requires a person to give notice of an acquisition of voting shares both to the company itself and to the London Stock Exchange. Notification must be in the form prescribed by the Panel on Take-Overs and Mergers. The acquiring shareholder must give details of its total shareholding, and notification must take place by midday on the business day following the date of the acquisition. This obligation arises in two circumstances, namely:

- Where, as a result of the acquisition, the shareholder holds shares in aggregate representing 15 per cent or more of the voting rights in the company; and
- Where his shareholding already representing 15 per cent or more of the voting rights is increased to or beyond any whole percentage figure as a result of an acquisition.

Under the Substantial Acquisition Rules, persons acting together are treated as a single shareholder having an aggregate shareholding equal to their combined separate shareholdings. Each person must comply with any obligations arising under the Substantial Acquisition Rules.

Companies Act 1985, Sections 198–220. In addition to the Substantial Acquisition Rules, above, a person who has an interest in voting shares in a public company must in certain circumstances notify the company of that interest under sections 198–220 of the Companies Act 1985. This obligation will arise in one of three situations, these being if a person:

- Knowingly acquires an interest (or knowingly ceases to be interested) in shares comprised in the company's relevant share capital;
- Becomes aware of an acquisition of an interest in such shares or ceases to be interested in such shares by a person with whom he is acting in concert (see text, below); or
- Becomes aware of anything that results in him having a 'notifiable interest' which he did not have before.

Notifiable Interest. The obligation to disclose a shareholder's interest is triggered by certain changes in the percentage of the relevant share capital which that person has or had an interest in. The 'notifiable percentage' is three per cent, and the obligation to disclose arises where there is a change from a holding below this notifiable percentage to above it or vice versa or where the percentage holding is at (or above) the notifiable percentage, both before and after the change, but the percentage level changes.

The 'percentage level' is defined as the percentage figure found by expressing the nominal value of all the shares in which the person has an interest as a percentage of the nominal value of the whole of the issued share capital of the company (rounded down).

Notification. Notification to the company must:

- Be made in writing within two days following the day on which the obligation notified arose;

- Give the name and address of the person notifying and, if he or she is a director, state that the notification complies with sections 198–202 of the Companies Act;
- Specify the share capital to which the notification relates;
- State the number of shares held by the person notifying; and
- Identify each registered holder of shares to which the notification relates and the number of shares held by each such person.

Interest in Shares. The obligation to notify arises only if the person has an 'interest in shares'. However, this is widely defined, and it includes the following situations:

- Where the shares are held on trust;
- Where there is a contract to buy the shares;
- Where there are 'put' or 'call' options over the shares; and
- Where the shares are held by a nominee.

In addition, the person can have an 'interest by attribution'. This includes the following:

- Any shares in which a person's spouse or infant child or step-child has an interest;
- Any shares in a company of which that person is a director or controls one-third or more of the voting rights at general meetings, or controls one-third of any holding company; and
- Any shares in which another person is interested, if the two parties are acting in concert (see text, below).

Parties Acting in Concert. Sections 204–207 of the Companies Act 1985 provide that, if persons are acting in concert in connection with the acquisition of shares in a particular public company, for the purposes of the obligation to disclose, the interest of any one of those parties in the shares of that company is attributable to the other parties and vice versa. For these provisions to apply:

- There must be an agreement between two or more persons which provides for the acquisition by any of them of an interest in shares and which imposes obligations or restrictions on at least one of the parties relating to the use, retention, or disposal of their interests acquired pursuant to that agreement; and
- There must be an acquisition of an interest in shares pursuant to the above agreement.

It should be noted that there are criminal penalties for failing to fulfil an obligation to disclose under these provisions.

Insider Dealing

In General. The Criminal Justice Act 1993 was enacted in July 1993, and it came into effect before the end of 1993. Part V of the Criminal Justice Act is designed to implement provisions of the EC Directive 89/592/EEC and to amend and restate the law relating to insider dealing in securities in the United Kingdom. The intention of the Directive is to

ensure that all member states make insider dealing illegal by adopting a common approach, as well as to introduce minimum standards throughout the EU and to facilitate crossborder policing and enforcement. The result is that a number of EU member states have enacted insider dealing legislation for the first time.

In addition to the Criminal Justice Act, insider dealing also is prohibited under the Financial Services Act 1986 (and by the various self-regulating organisations set up under the Financial Services Act 1986) as a result of which civil liability can attach to investment firms that fail to take precautions to prevent their staff engaging in insider dealing. Prohibitions on insider dealing also are contained in the Model Code of the London Stock Exchange and in the Take-Over Code of the Panel on Take-Overs and Mergers.

Criminal Justice Act 1993. The offence of insider dealing, as set out in section 52 of the Criminal Justice Act 1993, essentially occurs in one of three forms, namely, where an individual who has inside information:

- Deals in securities that are price-affected securities in relation to that information ('insider dealing');
- Encourages another person to deal in securities that are price-affected securities in relation to that information ('insider encouragement'); or
- Discloses that information to another person otherwise than in the proper performance of his employment, office, or profession ('insider disclosure').

It should be noted that only an individual can commit an offence under section 52. Therefore, there is no possibility of a company itself committing an offence, although the individuals responsible will themselves potentially fall within section 52. The benefit of excluding companies from those persons who are able to commit an offence under section 52 is that it enables companies to continue to trade in securities by the establishment of 'Chinese Walls'. A 'Chinese Wall' is an internal arrangement which is designed to prevent information being communicated from one part of a company's business to another part of the same company's business.

Insider Dealing. The basic prohibition on insider dealing is contained in section 52(1) of the Criminal Justice Act 1993, which provides that:

> An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in sub-section (3), he deals in securities that are price-affected securities in relation to the information.

Section 52(3) states that the circumstances referred to in section 52(1) are:

> . . . that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary.

From the above, it can be seen that there are essentially three requirements that need to be established before an offence has been committed. These are:

- An individual has information as an insider;
- The individual deals in securities that are price-affected securities; and
- Dealing occurs on a regulated market or in reliance on a professional intermediary (or the individual concerned deals while acting as a professional intermediary).

Information as Insider. Section 57(1) of the Criminal Justice Act 1993 states that:

> . . . a person has information as an insider if and only if: -
>
> (a) it is, and he knows that it is, inside information; and
>
> (b) he has it, and knows that he has it, from an inside source.

It is clear from section 57 that, in order for an individual to be found guilty of an insider dealing offence, he must both have and know that he has inside information from an inside source. Therefore, an individual is provided with a defence if he dealt in securities of a company on the basis of inside information if he can show that he did not know that the information was inside information. Alternatively, an individual may deal in securities on the basis of inside information if he is unaware that such information came from an inside source.

Under section 56(1) of the Criminal Justice Act 1993, in order for information to be inside information, it must be information that:

> Relates to particular securities or to a particular issuer of securities or to particular issuers of securities and not to securities generally or to issuers of securities generally;
>
> Is specific or precise;
>
> Has not been made public; and
>
> If it were made public, it would be likely to have a significant effect on the price of any securities.

Section 57(2) of the Criminal Justice Act 1993 states that:

> A person has information from an inside source if and only if:
>
> (a) he has it through:
>
> (i) being a director, employee or shareholder of an issuer of securities; or
>
> (ii) having access to the information by virtue of his employment, office or profession; or
>
> (b) the direct or indirect source of his information is a person within paragraph (a).

Section 57(2)(ii) of the Criminal Justice Act 1993 establishes that there must be a connection between a person's employment, office, or profession and access to such inside information. This ensures that an analyst who receives information from a company as a result of his employment will be treated as having received information from an inside source and, subject to the nature of the information received, is likely to be an insider. In addition to analysts, lawyers or merchant bankers who act for a bidder in respect of a take-over will have access to information in relation to the target company and, therefore, will be insiders in relation to that company.

Deals in Securities Which are Price-Affected Securities.

Section 55(1) of the Criminal Justice Act 1993 states that:

> A person deals in securities if:
>
> (a) he acquires or disposes of the securities (whether as principal or agent); or
>
> (b) he procures, directly or indirectly, an acquisition or disposal of the securities by any other person.

Article 4 of the Insider Dealing Order states that, for a security to be covered by the insider-dealing legislation, it must be 'dealt in or under the rules of, or have its price quoted on, a regulated market'.

Section 56(2) of the Criminal Justice Act 1993 states that securities are price-affected securities 'if and only if the information would, if made public, be likely to have a significant effect on the price of securities'.

It should be noted that the wording in section 56(2) mirrors the wording in section 56(1)(d), except that the information must be likely to have a significant effect on the price (or value) of the securities in which dealings take place. Therefore, it is clear that an individual who has inside information, but who deals in securities which do not relate to that inside information, will not be guilty of an offence of insider dealing.

Insider Encouragement. Section 52(2)(a) of the Criminal Justice Act states that:

> An individual who has information as an insider also is guilty of insider dealing if he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in sub-section (3).

Section 52(2)(a) is essentially an anti-avoidance measure which prohibits encouraging someone to deal in circumstances where he has not actually been given inside information.

Insider Disclosure. Section 52(2)(b) of the Criminal Justice Act 1993 states that:

> An individual who has information as an insider also is guilty of insider dealing if he discloses the information, otherwise than in the proper performance of the functions of his employment, office, or profession, to another person.

Section 52(2)(b) also is an anti-avoidance measure which prohibits disclosure of information that could be used for insider dealing. Section 62(2)(b) does not apply to an individual who discloses information in the proper performance of the functions of his employment, office, or profession.

Defences

Section 53 of the Criminal Justice Act 1993 provides the following three defences where an individual is *prima facie* guilty of insider dealing or encouraging, but can show that:

> . . . he did not at the time expect the dealing to result in a profit attributable to the fact that the information in question was price-sensitive information in relation to the securities.[71]
>
> . . . at the time he believed on reasonable grounds that the information had been disclosed widely enough to ensure that none of those taking part in the dealing would be prejudiced by not having the information.[72]
>
> . . . he would have done what he did even if he had not had the information.

In addition, Schedule 1 sets out a further four defences which fall within the categories of market maker, market information, and price stabilisation. Neither these, nor the above defences, provide any defence to a charge of insider disclosure. The burden of proof is on the individual to show that he falls within one of the defences in section 53 or in Schedule 1 to the Criminal Justice Act.

Penalties for Insider Dealing

Section 61 of the Criminal Justice Act 1993 provides that an individual who is convicted on indictment of the offence of insider dealing will be liable to a term of imprisonment of up to seven years and/or an unspecified fine. On summary conviction, an individual will be liable to a term of imprisonment of up to six months and/or a £5,000 fine. Proceedings in England and Wales for insider dealing offences may not be instituted without the consent of either the Secretary of State or Director of Public Prosecutions. Section 63(2) adds that no transaction will be void or voidable by reason only of an offence under section 52.

Territorial Scope of Offence of Insider Dealing

Section 62(1) of the Criminal Justice Act 1993 states that an individual is not guilty of an offence of insider dealing under section 52(1) (dealing in securities) unless:

- He was in the United Kingdom at the time when he is alleged to have done any act constituting or forming part of the alleged dealing;

71 The defence may apply where a person sold shares while in possession of information which he expected to receive a favourable reaction from the market.

72 This defence applies where the parties to a transaction are both in possession of inside information.

- The regulated market on which the dealing is alleged to have occurred is a United Kingdom regulated market (eg, the London Stock Exchange or LIFFE); or
- Any professional intermediary was in the United Kingdom at the time when an individual is alleged to have committed an act giving rise to the alleged offence.

Therefore, there must be at least a marginal territorial link between the actions giving rise to the offence and the United Kingdom. However, by virtue of section 62(1), it is not necessary for the dealing to have occurred in the United Kingdom or for the shares to be listed in London.

Section 62(2) of the Criminal Justice Act 1993 states that an individual is not guilty of an offence of insider dealing under section 52(2) (encouraging another or disclosing) unless:

- The individual was in the United Kingdom at the time when he is alleged to have disclosed the inside information or encouraged the dealing; or
- The alleged recipient of the information or encouragement was in the United Kingdom at the time when he is alleged to have received the information or encouragement.

Again, there must be a territorial link with the United Kingdom, namely, that either the insider or recipient was in the United Kingdom at the time of disclosure or encouragement. Section 62 is designed to provide an effective framework against insider dealing which has a significant United Kingdom component. This, together with provisions in other EU member states, should ensure that any insider dealing activity that takes place within the EU or on an EU-regulated market will be caught.

Public Take-Over Bids

Territorial Application (Foreign Bidder and Domestic Target)

The first point of reference for anyone involved with a public take-over in the United Kingdom is the City Code on Take-Overs and Mergers, which is controlled by the Panel on Take-Overs and Mergers (the 'Panel'). The Code provides an orderly framework within which take-overs are conducted. The Code applies to directors of companies that are subject to the Code and are involved with a potential take-over. It also applies to groups of people attempting to control such companies or who participate in, or are connected with, transactions to which the Code applies, eg, professional advisers.

All listed and unlisted public companies considered by the Panel to be resident in the United Kingdom, the Channel Islands, or the Isle of Man are controlled by the Panel, as are companies resident in the Irish Republic if their shares are listed on the London Stock Exchange. A company will normally be regarded as resident only if both its place of incorporation and its central management are in one of these jurisdictions. Therefore, if its central management moves, for example, to the United States or Spain, the Code's protection will end as regards that company even if it is still a United Kingdom company listed on the London Stock Exchange.

Furthermore, even if the directors of the company wish to continue to be controlled by the Code or incorporate a reference to the Code in the company's articles of association, the Panel will normally refuse to accept jurisdiction.[73] In this and other situations in which there is a foreign element, the proposed take-over will be subject to an overseas take-over regulator. Therefore, it would be necessary to consult the Panel to resolve any conflicts that may arise.

The fundamental aim of the Panel and the Code is to ensure that shareholders receive fair and equal treatment in connection with any actual or proposed take-over. To this end, a number of the Panel's members come from a wide selection of organisations including the Confederation of British Industry and the Association of British Insurers. The Chairman and Deputy Chairman are appointed by the Governor of the Bank of England.

The Panel and the Code do not consider all issues relating to take-overs. Matters of competition, for example, are dealt with by national legislation, case law and EU law. The Code is non-statutory and, as such, it does not have the benefit of being directly enforceable by law. Yet, the government and other city regulatory bodies have stressed the need for any take-over to comply with the Code's rules, and it has been considered by judges as setting appropriate standards and practices.[74]

The European Court of Justice insists on Directives being implemented by EU member states in such a way that they are legally enforceable. As the Code is non statutory, it may be deemed insufficient. The Panel is against changing its status, as this would destroy what it regards as its greatest advantages, ie, the speed, informality, and flexibly of its actions and its ability to meet the needs of unusual circumstances. However, it has been suggested that a carefully worded statute could continue the same approach.

The Panel also is concerned that the requirements of EU law will make it easier for those dissatisfied with its rulings to challenge them in the courts and to do so in the course of a bid itself. This might affect the Panel's record of giving binding rulings on the meaning of the Code during even the most hostile circumstances, which has prevented the need for the American pattern of regular resort to courts of law in similar circumstances.[75]

Connecting Factors and International Private Law Aspects

In General. As previously mentioned, the Panel does not address all issues in relation to a proposed public take-over. Perhaps the most important area outside its control relates to competition, ie, in this context, the need to avoid the creation of monopoly situations. In the United Kingdom, competition is controlled by both domestic and EU law.

United Kingdom Law. As far back as 1614, in the *Ipswich Tailors* case, English case law found that it was against public policy for any person or group of persons to secure the sole

73 Graham, *A Practitioner's Guide to the City Code on Take-overs and Mergers*, at p 17.
74 *Gething* v *Kilner* (1972) 1 WLR 337; *Dunford & Elliot Ltd* v *Johnson & Firth Brown* (1977) 1 Lloyd's Rep 505.
75 *Gower's Principles of Modern Company Law* (6th ed, 1997), at p 775.

exercise of any known trade throughout the country. Today, the prevention of monopolies is under the control of the Monopolies and Mergers Commission. The Monopolies and Mergers Commission has wide powers to investigate and report on companies where there appears to be a monopoly situation or a risk of one arising.

The Monopolies and Mergers Commission is obliged to investigate and report on any question referred to it under the Fair Trading Act 1973, including the creation or possible creation of a merger situation qualifying for investigation.[76] For a merger to be successfully referred to the Monopolies and Mergers Commission, at least one of the enterprises involved must be carried on in the United Kingdom or be a company incorporated in the United Kingdom.

European Law. As regards European competition law, the principal provisions are found in articles 85 and 86 of the Treaty of Rome (likely to be incorporated specifically into English law soon). As with all articles in the Treaty, these are very wide-ranging and purposive.

Article 85(1) states that all arrangements between undertakings that may affect trade between member states of the EU, and that have as their object or effect the prevention, restriction, or distortion of competition within the Common Market, are prohibited. In 1996, the European Commission published a Memorandum on the Concentration of Enterprises in the Common Market. This stated that article 85 was not applicable to agreements whose purpose was the acquisition of all or part of a company. However, article 86 targets abuse of a dominant position and, therefore, it may be relevant to large take-overs and their consequences.

In 1989, the Council of Ministers adopted the EC Merger Regulation.[77] From an international perspective, perhaps the most interesting feature of the Regulation is that the European Commission will investigate mergers that have a Community dimension. A Mergers Task Force is charged with the responsibility of applying the Regulation.

Article 21 of the Regulation states that mergers having a Community dimension should be investigated only by the Commission and that member states cannot apply their national competition legislation to such mergers. It follows that the Monopolies and Mergers Commission in such cases would not act.

Procedural Requirements

The Code is made up of 10 General Principles and 38 Rules. The General Principles describe the Panel's views in broad terms, and they should be interpreted to achieve their underlying purpose. They are aimed particularly at the need for fairness to shareholders. The Rules are more specific, although it also may be necessary to apply a wider approach to them. The Panel is keen to stress that the Panel's Executive should be approached at any time by anyone connected with a take-over if they are unsure about their proposed course of action. The Panel firmly believes that an immediate consultation will minimise the risk of a breach of the Code.

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76 Fair Trading Act 1973, s 5(1)(c).

In such circumstances, the general procedure is that the Executive will give a ruling. However, if the matter is particularly complex, it may be referred to the Panel for consideration. If either undertaking in the proposed take-over is listed on the London Stock Exchange, there are further procedural requirements which can be found in the Listing Rules.

A strict timetable must be followed, which includes the requirement that a notification of mergers be made not more than one week after the conclusion of an agreement, the announcement of a bid, or the acquisition of a controlling interest.

Recognition of Foreign Take-Over Regulation

It has been argued that, for the take-over of a company whose securities are traded in more than one country, one should apply the regulations of the main market of the target company The Code urges early consultation with the Executive in such circumstances so that guidance may be provided as to how any conflicts of law may be resolved (see text, below).

Jurisdictional Conflicts

In General

What Is 'Conflict of Laws'?

Wherever there is international trading, 'conflict of laws' becomes relevant. This is because contracts where the subject matter of the contract is international, or where the parties to the contract are in different jurisdictions, may become subject to the laws of more than one country. Those laws may sometimes conflict.

When they do, it is necessary to consider which law applies. It also is necessary and equally important to consider which jurisdiction is relevant for the purpose of determining the conflict of laws.

Countries for Purposes of Conflict of Laws

For the purposes of conflict of laws, France and Italy are examples of countries where the law is the same throughout; however, for these purposes, England, Scotland, and Northern Ireland are each regarded as separate countries, as are each of the Australian and American states and each Canadian province. Of course, this does not prevent certain laws from applying throughout the United Kingdom (England, Wales, Scotland, and Northern Ireland) or the entire United States or Canada.

Therefore, this section will distinguish between countries, so that references to England include England and Wales and references to the United Kingdom include England, Wales, Scotland, and Northern Ireland.

77 European Community Regulation 4064/89, OJ [1989] L 395/1.

Jurisdiction and Choice of Law

When a conflict of laws arises it is necessary to consider whether the English court has jurisdiction to entertain a case and, if it does, which law is to be applied to the dispute. On the basis that an English court will generally first consider whether it has jurisdiction, the jurisdictional issue will usually take precedence at the outset over establishing which country's law is to apply.

Securities-Related Issues

An owner of shares in an English company, whether that company is listed on a recognised exchange or not, will primarily be governed as regards the rights which those shares confer, by the articles of association of the company concerned. As is clear from other parts of this chapter, there are other sources of rules governing shares in a company (eg, the Companies Act and the Yellow Book for listed companies) and how they may be dealt with, but it is the articles of association that comprise the contract amongst the company and its shareholders and set out the rights and obligations of the shareholders.

The articles of association of an English company are subject to English law, and they will be governed by English law. Any action that a shareholder takes in his capacity as shareholder should always be in accordance with the provisions of the articles of association or his action may be invalid. For example, transfers of shares should always follow the procedures set out in the articles of association or they are likely to be invalid. This applies whether the shareholder is English or not; for example, a transfer of shares in an English company by an Italian shareholder will not be valid simply because the transfer has been completed in accordance with the laws of Italy.

Disputes governing English company procedural and constitutional matters, therefore, are inevitably to be determined by the English courts, and the issue of a 'conflict of laws' does not arise.

Of course, disputes where the subject matter of the dispute happens to be securities (eg, between two parties, one of whom is not English, and relating to the question of whether the sale of certain securities took place or not) may well require a consideration of the conflict of laws. An English court will usually enforce a contract which is valid under its governing law, even if it is unenforceable under English law (eg, for failure of consideration). However, English courts will not enforce:

- Rights or duties imposed by foreign laws which are contrary to a fundamental policy of English law;
- A foreign penal law;
- A foreign revenue law; or
- The public law of a foreign country.

Determination of Jurisdiction

The determination of jurisdiction in an action *in personam* depends on the issuing of proceedings against a defendant. If the defendant is in the English jurisdiction, proceedings

can usually be served on the defendant in England. It is irrelevant that his presence in the jurisdiction is brief or that the dispute has no real connection with England. If he is outside the jurisdiction, leave to serve out of the jurisdiction needs to be applied for.

The United Kingdom is party to two conventions in this area, ie, the Lugano Convention and the Brussels Convention. These provide for the recognition and enforcement of judgments in civil and commercial matters. The Brussels Convention applies to all member states of the EU. It follows that the European Court of Justice has the power to rule on the interpretation of the Convention and to deal with referrals from courts of member states. Under the Lugano Convention, all signatories agree to take account of the principles laid down by the courts of the other contracting states. Where a country is a member of the EU this will, of necessity, involve the principles set out in the Brussels Convention.

Although not strictly relevant to a chapter concerning securities, the Brussels and Lugano Conventions do not apply to the status or legal capacity of an individual's rights in property arising from wills, succession or marriage, bankruptcy, liquidation, judicial arrangement proceedings, social security, and arbitration, in which cases national law applies.

Any person can agree to submit to a certain jurisdiction and choice of law, which agreement it would be difficult to displace particularly if recorded in writing or otherwise clearly evidenced. Courts will usually give effect to such agreements on the basis that the parties have submitted to a jurisdiction and law of their choice. The general rule in the absence of express agreement under the Conventions is that a person domiciled in a contracting state must be sued in the courts of that state, whether or not the person in question is a national of that state. An individual is domiciled in the United Kingdom if he is resident in the United Kingdom and the nature and circumstances of his residence indicate a substantial connection with the United Kingdom.

Under the Brussels Convention and the Lugano Convention, the registered office of a company is to be treated as its domicile. There are a number of exceptions to these general rules where exclusive jurisdiction is conferred on courts of a particular contracting state, regardless of domicile. For example:

- Article 16, paragraph 2, of both the Brussels Convention and the Lugano Convention confers exclusive jurisdiction on the courts of the country in which a company has its registered office in relation to proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies, or the decisions of its organs (ie, board and shareholders' meetings);
- In proceedings regarding the validity of entries in public registers, exclusive jurisdiction is conferred on the contracting state in which the register is kept; and
- In proceedings regarding the enforcement of judgments, exclusive jurisdiction is conferred on the courts of the contracting state in which the judgment is to be, or has been, enforced.

Determination of Governing Law

The question of which law is to govern a contract is determined by reference to the rules of the Rome Convention, signed by the United Kingdom on 7 December 1981 and relevant

to contracts made after 1 April 1991. The Rome Convention applies generally, although most of the categories of cases excluded for the purposes of determining jurisdiction (see text, above) are excluded from the scope of the Convention. In addition, the Rome Convention does not apply to the personal liability of officers and members for the obligations of a company, evidence and procedure, obligations arising under bills of exchange, cheques and promissory notes, and other negotiable instruments to the extent that the obligations arise from their negotiable character.

Under the Rome Convention, a contract will be governed by the law chosen by the parties. Such choice may be express or must be capable of being ascertained by the terms of the contract or the circumstances of the case. Where no choice of law is made, the contract will be governed by the law of the country most closely connected to the contract. It is presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, if an individual, his habitual residence or, if a company, its central administration. If the contract is entered into in the course of that party's trade or profession, the relevant country will be the country in which the principal place of business is situated or, in the case of a contract which specifies a business in another country as the provider of the services, that country will be the relevant country.

If characteristic performance cannot be determined, the presumption will not apply. The same is true if the contract as a whole is more closely connected with another country. It should be noted that, if a contractual provision is unenforceable under English law, as being contrary to public policy or void or illegal according to the applicable law, it will not be enforced in the English courts.

If the Rome Convention does not apply, the proper law of the contract will govern the contract. The proper law will be determined in one of three ways, namely:

- By express choice of the parties;
- By inferred selection from the circumstances (eg, if a jurisdiction is chosen, it is likely that the court will decide that the law of that jurisdiction should also apply); and
- By judicial determination of the system of law with which the transaction has the closest and most real connection.

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United States

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Regulatory System

In General

In response to the stock market crash of 1929 and the Great Depression that followed, the United States Congress enacted a number of statutes that form the basis for the regulation of securities in the United States. These statutes are the cornerstone of the modern United States federal securities regulatory system.[1]

The securities laws are intended to assist in facilitating capital formation by issuers (entities that issue securities to investors), while emphasising the need to provide full and fair disclosure to potential investors and existing shareholders. The basic tenet of the United States securities laws is not to directly control or prevent investment or to substitute the judgment and values of the government for market forces. Rather, the legislation mandates disclosure standards and patterns of behaviour so that information made available by issuers accurately reflects the business operations, risks, and benefits of a new investment or existing operation.

The objective is to make readily available sufficient accurate information so that potential investors can make a fully informed decision whether to buy, to continue to hold, or to sell a security. The United States securities laws also provide severe penalties to deter misrepresentation, deceit, and other fraudulent behaviour and to penalise persons or entities that act outside the law and regulations.

Securities transactions in the United States are subject to regulation at both the federal and the state level. However, the primary regulation of securities laws is on the federal level. Federal pre-emption, over competing state interests, stems from the Interstate Commerce Clause of the United States Constitution.[2] Federal securities laws preserve the right of the

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1 The authors wish to acknowledge the assistance of William L Blum, Allen E F Rozansky, Michael J Semack, and Timothy R Spiel, attorneys at Solomon Pearl Blum Heymann & Stich LLP, in the research, preparation, and updating of this chapter.

2 United States Constitution, art I, s 8.

various states to enact laws to regulate securities transactions, so long as such enactments do not conflict with the federal law.[3]

Those transactions that are wholly within a state, or which do not affect interstate commerce, are those primarily regulated by state securities laws, although the impact or applicability of state securities laws should be considered and evaluated on all transactions. Known as 'blue sky' laws, the state laws regulate activities within each state, such as registration or exemption of securities transactions within the state and registration of brokers and dealers who operate within the state. Administration within a state is left to state securities law commissions which promulgate rules and regulations for securities transactions within those state borders.

This chapter focuses on the United States federal law with regard to international securities transactions. It is intended to provide an overview of federal securities law as applied to international transactions.

The chapter has been updated from previous releases to include recent changes regarding a harmonised international disclosure standard. While the chapter outlines the impact these changes are intended to have, there will undoubtedly be ramifications and other developments that have been anticipated. Practitioners should continue to track and monitor these developments.

Federal Law

From 1933 to 1940, the United States Congress enacted a number of statutes that form the basis for the securities regulation in the United States. These statutes, and the rules and regulations promulgated under the authority granted to the United States Securities and Exchange Commission as part of the applicable law, form the cornerstone of the modern federal securities regulatory system. These Acts[4] are as follows:

- The Securities Act of 1933,[5] commonly known as the 'Securities Act' or the '1933 Act', regulates the activities of the issuers of securities and the offer and sale of securities;
- The Securities and Exchange Act of 1934,[6] commonly known as the 'Exchange Act' or the '1934 Act', established the United States Securities and Exchange Commission and regulates the trading of securities;
- The Investment Company Act of 1940,[7] commonly known as the 'Investment Company Act', regulates the activities of investment companies; and

3 See, eg, National Securities Markets Improvement Act of 1996, Public Law Number 104-290 (1996).

4 In addition, two other significant laws were enacted during this era which still have applicability to certain United States securities law issues, ie, the Public Utility Holding Company Act of 1935, 15 United States Code, ss 79 *et seq*, and the Trust Indenture Act of 1939, 15 United States Code, ss 77a *et seq*; however, these Acts are outside the scope of this chapter.

5 Securities Act of 1933, 15 United States Code, ss 77a *et seq*.

6 Securities and Exchange Act of 1934, 15 United States Code, ss 78a *et seq*.

7 Investment Company Act of 1940, 15 United States Code, ss 80a *et seq*.

- The Investment Advisers Act of 1940,[8] commonly known as the 'Investment Advisers Act', regulates the activities of investment advisors.[9]

Securities and Exchange Commission

The United States Securities and Exchange Commission was formed under the Exchange Act,[10] and it is charged with the administration and enforcement of the United States securities laws. The Securities and Exchange Commission has broad rule-making authority to accomplish its goals to provide protection for investors. Its primary focus is to ensure that securities markets are fair and honest. Rules and regulations promulgated by the Securities and Exchange Commission affect all aspects of the United States capital markets, including the issuance and after-market trading of securities, and the registration of brokers and dealers, investment companies, and investment advisors.[11]

Part of the authority of the Securities and Exchange Commission is carried out through management and oversight of self-regulatory organisations, which today include the major United States securities exchanges, and the National Association of Securities Dealers, Inc (NASD). Whether the issue is the sale of securities, the trading of securities, the organisation of stock exchanges, the role of underwriters or broker-dealers, the availability of credit for stock transactions, or the use of investment companies or advisors, it is primarily the Securities and Exchange Commission that proscribes behaviour, monitors activities, and penalises wrongdoers. The Securities and Exchange Commission also serves as an adviser to the United States federal courts in corporate reorganisation proceedings under chapter 11 of the Bankruptcy Reform Act of 1978, as amended.[12]

The Securities and Exchange Commission consists of five commissioners appointed by the President and confirmed by the United States Senate (each a 'Commissioner' and, collectively, the 'Commissioners'). The Securities and Exchange Commissioners serve staggered five-year terms.[13] To ensure that the Securities and Exchange Commission remains non-partisan, no more than three Commissioners may belong to the same political party. The Securities and Exchange Commission headquarters are in Washington, DC, although the Securities and Exchange Commission has numerous field offices throughout

8 Investment Advisers Act of 1940, 15 United States Code, ss 81a *et seq*.

9 Generally, those investment advisers who (a) have more than US $25 million of assets under management, or (b) are advisers to a registered investment company under the Investment Company Act, or (c) are required to register as investment advisers in 30 or more states, are required to register as 'Investment Advisers' with the Securities and Exchange Commission. Investment advisers who do not meet these thresholds are prohibited from registering with the Securities and Exchange Commission, and are governed in accordance with the applicable state investment adviser statutes. Investment Advisers Act Release Number IA-1733 (July 1998).

10 Securities and Exchange Act of 1934, 15 United States Code, s 78d.

11 See 17 Code of Federal Regulations, ss 230 *et seq*, for rules and regulations promulgated under the 1933 Act and 17 Code of Federal Regulations, ss 240 *et seq*, for rules and regulations promulgated under the 1934 Act.

12 Bankruptcy Reform Act of 1978, 11 United States Code, ss 364, 1125, and 1145.

13 Securities and Exchange Act of 1934, 15 United States Code, s 78d.

the United States. The staff of the Securities and Exchange Commission is organised into divisions and offices with specific areas of responsibilities. The major divisions are:

- The Division of Corporation Finance, which is responsible for ensuring that disclosure requirements are met by publicly held companies whose securities are registered with the Securities and Exchange Commission;
- The Division of Market Regulation, which is responsible for registration and regulation of broker-dealers and oversight of the nation's stock exchanges, transfer agents, and clearing organisations;
- The Division of Investment Management, which is responsible for administering investment companies and investment advisers; and
- The Division of Enforcement, which is responsible for enforcing the federal securities laws and regulations.

In addition, the Office of the Chief Accountant has the responsibility for advising the Securities and Exchange Commission on accounting and auditing matters while creating policies to achieve compliance with accounting and financial disclosure standards. This office oversees private sector efforts at the Financial Accounting Standards Board and the American Institute of Certified Public Accountants to improve financial and auditing standards and financial disclosure.

The Office of International Affairs of the Securities and Exchange Commission has primary responsibility for the international enforcement of United States securities laws and regulatory co-operation among international securities regulators. Its duties include the investigation of suspected unlawful conduct, market surveillance, and the oversight of regulated entities in cross border transactions. The Office of International Legislative Affairs also assists with international litigation matters, including:

- Service of process;
- Gathering of evidence; and
- Enforcing of judgments abroad.

In addition to its enforcement activities, staff members engage in ongoing discussions with their non-United States counterparts, including the International Organisation of Securities Commissions (IOSCO) and the Council of Securities Regulators of the Americas, to facilitate cross border transactions, and to assist other countries and their regulatory bodies in developing policies to provide for investor protection, education, and confidence.

The Securities and Exchange Commission has the pre-eminent role in the regulation of United States securities matters, including cross border securities matters. It has power to:

- Make rules;
- Examine and inspect regulated entities to determine compliance with law;
- Interpret and provide guidance on the securities laws;
- Investigate complaints and indications of possible law violations; and

- Provide statutory sanctions and enforce the securities laws and rules by administrative action, conduct civil litigation, and refer criminal conduct for potential prosecution.

The Securities and Exchange Commission will exercise its prosecutorial powers to safeguard the integrity of the markets. The manifestation of these prosecutorial powers is evidenced by the fact that, in 1999, the Securities and Exchange Commission's investigations and actions resulted in court orders requiring non-compliant parties to disgorge illegal profits of approximately US $650 million. Civil penalties authorised by the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, the Insider Trading Sanctions Act of 1984, and the Insider Trading and Securities Fraud Enforcement Act of 1988 totalled more than US $191 million.[14]

Conspicuously absent from its duties and authority listed above is the ability of the Securities and Exchange Commission to approve, disapprove, or guarantee the value or merit of any security. Moreover, the Securities and Exchange Commission will not bar from sale any security, even if the security has questionable value, although it may halt trading in securities that are the subject of illegal market manipulation activities. That is because the Securities and Exchange Commission's role is to ensure that issuers and market participants fully comply with securities laws and provide full and fair disclosure. The ultimate investment decision is left for the investor to make.

Notwithstanding the fact that the Securities and Exchange Commission does not pass on the merits of any security, the testimonial as to the issuer's belief and faith in the United States market is revealed in the following statistics:

- Securities filings reached US $2.1 trillion in 1999;
- Common stock offerings of almost US $1.18 trillion were filed for registration in 1999; and
- Offerings filed by the first time registrants (IPOs) totalled approximately US $118 billion.

As further evidence of the United States market's strength, non-United States companies' participation in the United States public market continued to show strong growth in 1999. During 1998, nearly 164 foreign companies from 34 countries entered United States public markets for the first time. At year-end 1999, there were nearly 1,200 non-United States companies from 57 countries filing reports with the Securities and Exchange Commission. More than US $244 billion was registered in 1999 by non-United States companies for public offerings which set a record for an amount registered in a single year.[15]

State Law

Although federal law applies to securities transactions that take place across state borders, many states also have enacted their own state securities laws, commonly known as state

14 Securities and Exchange Commission, 1999 Annual Report.
15 Securities and Exchange Commission, 1997 Annual Report.

blue sky laws, to cover the offer and sale of securities, registration of broker-dealers, and trading of securities by citizens within a state's boundaries. In addition, securities transactions that occur in many states (which is common place for a large offering or an IPO) will be subject to the blue sky laws in each of those states.

Some of these blue sky laws, however, have now been specifically pre-empted under the National Securities Markets Improvement Act of 1996.[16] For example, states may no longer regulate the availability or the substance of an offering of securities that is exempt from registration under rule 506 of Regulation D promulgated under the Securities Act. Rather, they may only require that a notice filing, along with a filing fee, be delivered to their state securities commissioner. If, however, the state suspects securities fraud, it may request additional information and review the offering materials.

These statutes also cover 'intrastate' transactions in securities that are exempt from federal law by reason of the issue being offered and sold only to persons resident within a particular state or territory, where the issuer of the security is a person resident and doing business or, if a corporation, incorporated by and doing business, within such state or territory.[17] Typically, these laws also have enforcement mechanisms which provide for penalties and sanctions for omissions or misrepresentations or other fraudulent behaviour.

In addition to any applicable blue sky laws, individuals who act as 'investment advisers' and are not otherwise registered with the Securities and Exchange Commission under the Investment Advisers Act may be subject to certain state investment adviser statutes and regulations. Practitioners should consult the rules and regulations of the applicable state to insure compliance with these directives.

Extraterritorial Reach of United States Securities Laws

In General

Increasingly, world financial markets have become more integrated and internationalised. Listings of non-United States issuers on United States exchanges and markets have surged and the consolidation of industry and commerce among international conglomerates with United States ties has increased the jurisdictional reach of the United States securities laws. This trend has focused attention on the extraterritorial reach of the United States securities laws.

More than 20 years ago, it was observed that '[w]ith increasing frequency foreigners are becoming concerned with the extraterritorial reach of the United States securities laws'.[18] As financial markets have developed and integrated, what was once an observation of an infant trend is now an every day occurrence. A practitioner analysing the extraterritorial reach of the United States securities law must first identify the specific United States

16 National Securities Markets Improvement Act of 1996, Public Law Number 104-290 (1996).
17 Securities Act of 1933, 15 United States Code, s 77c(a)(11).
18 Hacker and Rotunda, 'The Extraterritorial Regulation of Foreign Business under the United States Securities Laws', 59 *NCL Rev* 643 (1981).

securities laws at issue and then analyse the specific facts and circumstances involved to determine whether United States securities law concepts apply.

Registration

In the case of the registration of securities under the Securities Act, the law is clear as to extraterritoriality. The Securities and Exchange Commission has noted:

> . . . [u]nder the Securities Act, any issuer that seeks to offer or sell its securities publicly in the United States must register the offer and sale of those securities with the [Commission]. This requirement applies equally to securities issued by either United States or [non-United States] companies, including mutual funds.[19]

In 1990, the Securities and Exchange Commission adopted Regulation S to clarify the extraterritorial application of the registration provisions of United States securities laws.[20] Regulation S employs a territorial approach, by which any offer or sale of a security that is deemed to occur within the United States is subject to the registration provisions of United States securities laws, while any offer or sale of a security that is not deemed to occur within the United States is not subject to the registration provisions of United States securities laws.[21]

Regulation S is not an exemption from registration under United States securities laws; rather, it provides that offers and sales occurring outside of the United States are not subject to the registration requirements of United States securities laws.[22]

Antifraud Provisions

When it comes to the application of the antifraud provisions of the 1934 Act, however, the law is not as clear.

Section 10b of the 1934 Act, and more specifically rule 10b-5 promulgated thereunder, constitutes the primary 'Antifraud Provisions' of the United States securities laws. They serve the purpose of protecting investors, registrants, and the markets from unethical and manipulative practices. These broadly drawn provisions are a 'catch-all' provision whose breadth is necessary to police and ensure fair dealings in the securities markets.

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19 Krechew, Securities and Exchange Commission No-Action Letter (5 November 1997), which held that non-United States mutual funds which offer securities in the United States must register with the Securities and Exchange Commission under both the 1933 Act and the Investment Company Act of 1940, unless exemptions from registration apply.

20 Securities Act Release Number 6863 (24 April 1990).

21 17 Code of Federal Regulations, s 230.901.

22 A full description of Regulation S and its applicability is discussed later in this chapter.

The Securities and Exchange Commission has recently adopted Regulation FD in an effort to further promote full and fair disclosure of information by issuers. Simultaneous with the adoption of Regulation FD, the Committee also adopted rules 10b5-1[23] and 105b-2,[24] which clarify and enhance the policing of prohibited insider trading activities.[25]

As a general canon of construction:

> . . . legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States which is based on the assumption that Congress is primarily concerned with domestic conditions.[26]

Nonetheless, the United States federal courts have established a two-level test — an 'effects test' and a 'conduct test' — under which they will determine whether or not subject matter jurisdiction exists and, if it does, it will extend the antifraud provisions of the 1934 Act extraterritorially.[27]

Existence of Subject Matter Jurisdiction

Generally, a United States federal court will have jurisdiction over the subject matter of a claim, despite the fact that the conduct in question occurred outside the United States, if such conduct produces substantial effects on United States markets or United States investors. This is known as the 'effects test'. This test was first enumerated by the Second Circuit Court of Appeals in *Schoenbaum v Firstbrook*.[28] In that case, it was held that s 10(b)[29] and rule 10b-5[30] applied to the conduct of a Canadian corporation that sold shares of its common stock to a French purchaser at a price substantially higher than that paid by the Canadian corporation's joint venture partner, another Canadian corporation.

The court came to this conclusion despite the fact that all of the parties involved were non-United States entities. The reasoning of the case focused on the fact that the Canadian issuer was listed on the American Stock Exchange, which is located in the United States, and had, among others, United States shareholders. It said:

> [T]he antifraud provision of s 10(b), which enables the [Commission] to prescribe rules "necessary or appropriate" in the public interest or for the protection of investors' reaches beyond the territorial limits of the United States

23 17 Code of Federal Regulations s 240.10b5-1.
24 17 Code of Federal Regulations s 240.10b5-2.
25 Securities Act Release 7881; Exchange Act Release 43154 (15 August 2000).
26 *Zoelsch v Arthur Andersen and Co*, 824 F2d 27, at p 31 (DC Cir, 1987), *cert denied*, 395 United States 906.
27 As will be discussed below, jurisdiction over the 1934 Act lies exclusively with the federal courts and not the courts of the individual states.
28 *Schoenbaum v Firstbrook*, 405 F2d 200 (2nd Cir, 1968) *cert denied*, 395 United States 906 (1969).
29 Securities and Exchange Act of 1934, 15 United States Code, s 78j.
30 17 Code of Federal Regulations, s 240.10b-5.

> and applies when a violation of the rules [promulgated under section 10(b)] is injurious to United States investors.[31]

If, on the other hand, there is no effect on United States investors or the United States securities markets, the courts may still find that subject matter jurisdiction exists when conduct inside the United States directly caused the losses suffered by investors outside of the United States, ie, the 'conduct test'. It is important to note that, although the trend is to find subject matter jurisdiction in an increasing number of situations, the United States federal courts have split in regard to the level of conduct that will cause them to have jurisdiction.

For example, the Courts of Appeal for the Second, Fifth, and Seventh Circuits and the District of Columbia Circuit have held that jurisdiction will lie in the American courts only where the conduct is not merely preparatory to the alleged fraud, but rather comprises all the elements of a defendant's conduct necessary to establish a violation of s 10(b) or rule 10b-5; for example, the fraudulent statements or misrepresentations must originate in the United States, must be made with scienter in connection with the sale or purchase of securities, and must cause the harm to those who claim to be defrauded, even though the actual reliance and damages may occur elsewhere.[32]

The Third, Eighth, and Ninth Circuits, conversely, have applied a less strict standard, holding that subject matter jurisdiction will exist when the conduct in question merely 'was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment'.[33] Thus, it is essential for a practitioner to review the holdings of the Federal Circuit Court in the geographic area where the activity took place prior to initiating any action in the United States based on alleged fraudulent conduct of a non-United States entity or person.

United States Markets and Market Listing Requirements

In General

In the United States, there are two basic types of stock markets or exchange on which a company, an 'issuer', can elect to have its securities trade. The first type is a centralised or fixed stock exchange where shares are traded in one central location through specialists that auction or execute buy and sell orders at the best available price. The best known

31 *Schoenbaum* v *Firstbrook*, 405 F2d 200 (2nd Cir, 1968), *cert denied*, 395 US 906 (1969).

32 *IIT* v *Cornfeld*, 619 F2d 909, 920 and 921 (2nd Cir, 1980); *Robinson* v *TCI/US West Cable Comm Inc*, 117 F3d 900 (5th Cir, 1997); *Kauthur SDN BHD v Sternberg*, 149 F3d 659 (7th Cir, 1998) cert denied, 119 SCt 890, ____ US ____ (1999); *Zoelsch* v *Arthur Andersen and Co*, 824 F2d 27 (DC Cir, 1987).

33 *Continental Grain* (*Australia*) *Pty Ltd* v *Pacific Oilseeds*, *Inc*, 592 F2d 409, at p 421 (8th Cir, 1979); *Securities and Exchange Commission* v *Kasser*, 548 F2d 109 (3rd Cir, 1977), *cert denied*, 431 US 938 (1977); *Grunenthal GmbH* v *Holtz*, 712 F2d 421 (9th Cir, 1983).

examples of a centralised, specialist-based, physical stock exchange are the New York Stock Exchange[34] and the American Stock Exchange.[35]

In addition to the New York Stock Exchange and the American Stock Exchange, there are a number of smaller regional exchanges that often specialise in certain defined types of activities, such as the Chicago Board Options Exchange which specialised in the trading of options, or which focus on a certain geographic area, such as the Pacific Stock Exchange.[36]

The second type of stock market or exchange is an over-the counter market where securities are traded by a system that links brokers and dealers who buy and sell securities for clients without physical proximity but instead interact through computer networks. The NASDAQ is an example of an over-the counter market. This over-the counter market is regulated by the National Association of Securities Dealers. The NASDAQ Stock Market is comprised of:

- The NASDAQ National Market for larger companies; and
- The NASDAQ SmallCap Market for emerging growth companies that are generally smaller, less seasoned issuers.[37]

Some of the world's largest technology companies, including Microsoft, Oracle, Sun Microsystems, and Cisco, trade on the NASDAQ.

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34 The most prestigious national securities exchange in the United States is the New York Stock Exchange. The New York Stock Exchange provides a liquid, tightly regulated market for the most seasoned of issuers. More information about the New York Stock Exchange can be found at the New York Stock Exchange web site, www.nyse.com, which is an excellent source of information.

35 The National Association of Securities Dealers, Inc, is the largest securities-industry, self-regulatory organisation in the United States. It is the parent organisation of the American Stock Exchange, LLC, NASD Regulation, Inc, and NASD Dispute Resolution, Inc. For more information about the NASD and its subsidiaries, see the following Web sites: www.nasd.com, www.nasdaq.com, the NASDAQ Newsroom at www.nasdaqnews.com, www.amex.com, www.nasdr.com, or www.nasdadr.com. The NASDAQ Stock Market Inc (the 'NASDAQ') was previously a wholly owned subsidiary of the National Association of Securities Dealers. However, under a recent reorganisation and recapitalisation of NASDAQ, the National Association of Securities Dealers has reduced its ownership stake in the NASDAQ with the ultimate goal being to create an independent investor-owned NASDAQ, which would permit the National Association of Securities Dealers to focus on tough, fair, and efficient regulation. The American Stock Exchange continues to operate as a separate specialist-based auction market, like the New York Stock Exchange. Historically, the American Stock Exchange was the market for smaller companies than those listed on the New York Stock Exchange but, in recent years, its market and the number of its listed companies has eroded due to the success of the New York Stock Exchange in the fixed, physical location specialist-based auction market favoured by 'blue chip' companies and the success of the NASDAQ in the computer-based trading market favoured by 'technology' companies. As a result of these defections and filing tendencies, the American Stock Exchange has evolved to become a leader in offering markets for option trading and other derivative products.

36 Other active registered securities exchanges include regional exchanges such as the Boston Stock Exchange, the Cincinnati Stock Exchange, the Chicago Stock Exchange, and the Philadelphia Stock Exchange.

37 The NASDAQ Stock Market also includes among its subsidiaries NASDAQ International, which is 'the trans-Atlantic extension of the NASDAQ Stock Market' that operates during the London and European trading hours.

Another group, Pink Sheets LLC, which was formerly known as the National Quotation Bureau (NQB), provides lists of securities, commonly known as the 'Pink Sheets', reporting trades for relatively thinly traded over-the-counter (OTC) securities. This name was derived from the fact the original pink sheets, listing these over-the-counter transactions, were printed on pink paper. They are now tracked both electronically and via print products.

Due to an increase in the number of issuers delisted or dropped by the OTC Bulletin Board, Pink Sheets has expanded its quotation service and has recently introduced real-time pricing. It is anticipated that these services will bring more liquidity and more transparency to these markets.[38]

In addition, brokers-dealers can report trades for small, less widely traded securities on the OTC Bulletin Board. The OTC Bulletin Board is not an actual stock exchange but merely an electronic bulletin board service.

Non-United States entities seeking to list on a United States stock exchange or market must adhere not only to the requirements of the Securities and Exchange Commission, but to those of the stock exchange or market where the securities are listed or intend to be listed. Whether the issue is the sale of securities, the trading of securities, the organisation of stock exchanges, the role of underwriters or broker-dealers, the availability of credit for stock transaction, or the use of investment companies or advisors, it is primarily the Securities and Exchange Commission that proscribes behaviour, monitors activities, and penalises wrongdoers.

In addition to the Securities and Exchange Commission's regulations, the exchanges are self-regulatory organisations that maintain their own qualitative listing requirements for issuers, beyond those mandates imposed by the Securities and Exchange Commission. Each of these major stock exchanges and markets outline their specific compulsory listing requirements in their respective listing markets.

Recent technological developments and the worldwide growth of the Internet may provide another alternative for trading securities. In 1996, several small, development-stage companies began to make a market for their own shares through the facilities of the world wide web. The Securities and Exchange Commission is closely monitoring developments on the Internet, and it has interceded aggressively to halt behaviour deemed detrimental to investors. The Securities and Exchange Commission has since issued a 'no-action letter' that permitted a company to make a market in its own shares using the Internet under certain circumstances.[39]

Non-United States entities are welcome and encouraged to exclusively list their securities on all the available exchanges and markets. Non-United States entities that are evaluating listing on an exchange or market, or moving from one exchange to another, need to carefully weigh the requirements and benefits of each choice in hopes of having its securities

38 Pink Sheets web site visited 1 April 2001. More information about the Pink Sheets can be found at the web site www.pinksheets.com.

39 Real Goods Trading Corp, 28 Securities Regulations and L Rep (BNA) 850; Securities and Exchange Commission No-Action Letter (25 June 1996).

actively traded where shareholders are provided liquidity in good markets and bad, and where the quantitative and qualitative disclosure requirements are not unduly burdensome. Often representatives from the exchange and the issuer will meet to discuss and evaluate the prospects for a successful listing.

American Depository Receipts

Foreign entities have the option of directly listing their shares on an exchange or to create a new security, known as an American Depository Receipt (ADR). An American Depository Receipt is a negotiable instrument issued by a third party depositary, usually a United States bank or its foreign affiliate, and it represents a specified number of shares or units of the underlying issuer which are held by the depository on behalf of the American Depository Receipt holders.

Trades in the United States on United States exchanges and markets are affected in the American Depository Receipt and not in the underlying securities. Often, an American Depository Receipt is used so that securities traded in the United States are denominated in United States dollars and can meet the minimum price requirements of the listing exchange or market.[40]

Major Exchanges and Markets

New York Stock Exchange

In General. The most prestigious national securities exchange in the United States is the New York Stock Exchange. The New York Stock Exchange provides a liquid, tightly regulated market for the most seasoned of issuers. More than 3,025 of the world's leading companies list on the New York Stock Exchange. Of these, more than 434 non-United States entities are listed, representing 49 countries.[41] One reason for the prestige of this exchange is its exacting listing requirements. By executing a New York Stock Exchange listing agreement, a company agrees not only to strictly abide by the United States securities law, but also to conform to a demanding series of requirements and obligations which are required to continue to enjoy listing privileges on the New York Stock Exchange.

These requirements go beyond quantitative criteria for initial or continuing listing, such as the value of the company, the public float, and the number of shareholders, and include corporate governance criteria that require the company to take actions that would not otherwise be required or to refrain from actions which the company might otherwise be entitled to take. In addition, the New York Stock Exchange reviews the degree of national interest in the company, its relative position and stability in the industry, and whether it is engaged in an expanding industry with the prospect of at least maintaining its relative position.

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40 A full description of the use of the American Depository Receipt and its applicability is provided later in this chapter.

41 New York Stock Exchange web site, http://www.nyse.com (1 April 2001).

Listing on the New York Stock Exchange provides the non-United States company with the opportunity to raise capital efficiently and economically in the United States, to enhance the marketability and liquidity for its shares, to develop a broad base of individual and institutional support and following, to facilitate mergers and acquisitions, and to enhance name recognition of the corporation's products and services.

Non-United States issuers may list on the New York Stock Exchange concurrently with their initial entry into the United States capital markets, whether through an offering of securities or not, or by transferring the listing from another United States exchange or stock market.

Non-United States companies have the option of seeking to qualify for listing with the New York Stock Exchange either by the New York Stock Exchange's standard domestic listing criteria or by special listing standards exclusively reserved for non-United States companies. The criteria for non-United States companies focus on the worldwide distribution of shares and they apply where there is a broad, liquid market for a company's shares in its country of origin.

The criteria for domestic companies focuses more on the United States market as the principal market and the minimum distribution of the issuer's stock within that market. Whatever criterion is used, an applicant company must meet or exceed all of the criteria within the standards under which it seeks to qualify for listing.

The listing requirements and procedures for non-United States entities[42] are as follows:

- Non-United States Company Listing Standards — Round-lot holders (holders of 100 or more shares), 5,000 worldwide; public shares (shares not held by insiders or control persons), 2.5 million worldwide; market value of public shares, US $100 million worldwide; net tangible assets, US $100 million worldwide; pre-tax income (aggregate for last three years), US $100 million worldwide; and minimum pre-tax income in each of the two most recent years, US $25 million worldwide.[43]
- United States Company Listing Standards — Alternative 1: round-lot holders, 2,000 United States or total shareholders, 2,200 United States; and minimum average monthly trading volume for the most recent six months, 100,000 shares; or Alternative 2: total shareholders, 500; and minimum average monthly trading volume for the most recent 12 months, 1 million shares.[44]

A third alternative exists which is intended to provide an opportunity for companies that are valued more on the basis of 'cash flow' than reported income to become listed, depending on the outcome of a due diligence review by the New York Stock Exchange. In

42 New York Stock Exchange, Listing Standards and Procedures (1999). The Listing Standards for both United States and non-United States Corporations can be found at the New York Stock Exchange web site. http://www.New York Stock Exchange.com (1 April 2001).

43 If the foreign entity meets all of the financial criteria but, due to the use of bearer shares outside of the United States, has difficulty in demonstrating that it has the required number of shareholders on a worldwide basis, the New York Stock Exchange provides that a New York Stock Exchange member may 'sponsor' the applicant and verify the liquidity and depth of the market for a company's shares.

performing its due diligence analysis, the New York Stock Exchange will consider each company on a case-by-case basis and will examine not only the specifics of the company's business but also will look to its industry, peer group, and other relevant factors.

Non-Numerical Requirements. Beyond numerical criteria, other factors are considered when determining eligibility for listing. The New York Stock Exchange requires that listed United States companies meet certain criteria with respect to outside directors, audit committee composition, voting rights, and related-party transactions. In general, the New York Stock Exchange will accept corporate governance practices of non-United States companies that do not comply with New York Stock Exchange policies to the extent that such practices are not prohibited by the home country law of the non-United States issuer and are accompanied by written certification from independent counsel of the company's country of domicile stating that the company's corporate governance complies with home country law.[45] The following is a summary of these policies.

Corporate Governance Requirements. Corporate governance requirements relate to issues such as outside directors, the audit committee, voting rights, and related-party transactions.

Outside Directors. Since 1956, all United States companies listing on the New York Stock Exchange must have a minimum of two outside directors.[46] For those companies which do not have outside directors at the time their eligibility for listing is approved, the New York Stock Exchange will normally require one outside director to be appointed prior to listing and a second within one year after listing. An outside director is a director who is not:

- An employee, officer, or former officer of the company or a subsidiary or division thereof;
- A relative of a principal executive officer; or
- A person who is an individual member of an organisation acting as an advisor, consultant, or legal counsel who is receiving compensation on a continuing basis from the company in addition to directors' fees.

The New York Stock Exchange encourages discussion with an Exchange representative to clarify any uncertainty with regard to qualification of outside directors.

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44 For either Alternative 1 or 2 — minimum public shares, 1.1 million United States; market value of public shares, US $40 million; net tangible assets, US $100 million and one of the following: (a) most recent year pre-tax income, US $2.5 million; each of two preceding years' pre-tax income, US $2 million; or (b) aggregate pre-tax income for the last three years, US $6.5 million; minimum in most recent year pre-tax income, US $4.5 million (all three years must be profitable); or (c) for companies with not less than US $500 million in market capitalisation and US $200 million in revenues in the most recent fiscal year, an aggregate for the three years' adjusted net income, US $25 million (each year must report a positive amount).

45 New York Stock Exchange, Listed Company Manual rule 303.00.

46 General footnote to New York Stock Exchange Listed Company Manual rule 303.01.

Audit Committee. Each United States company seeking to list on the New York Stock Exchange (and each non-United States company electing to qualify for listing under the United States company listing criteria) must have an audit committee comprised solely of directors independent of management and free from any relationship that would interfere with the exercise of independent judgment as a committee member.

Audit Committees in the United States were originally established to protect against abnormally 'cosy' relationships between the board of directors and the issuer. The Securities and Exchange Commission recently adopted rules to further protect against perceived improprieties and to 'improve communications through greater disclosure between management, the Board and outside auditors'.[47] The sum and substance of these changes are the following:

- Requires proxy statement disclosure of whether or not the audit committee has: (a) reviewed the audited financial statements with management; (b) discussed the quality of the company's accounting principals with outside auditors; (c) received evidence as to the independence of the outside auditors; (d) determined if anything has come to its attention that causes it to believe that the audited annual financial reports contain an untrue statement of a material fact or omit to state material facts necessary to make the statements made not misleading;
- Requires proxy statement disclosure of whether or not the audit committee has adopted a written charter (which, if adopted, is to be included in the proxy statement every third year);[48]
- Requires disclosure of whether audit committee members satisfy the New York Stock Exchange, National Association of Securities Dealers, or American Stock Exchange requirements as to independence;
- Creates a safe harbour that the proxy statement disclosure regarding the audit committee requirements is exempt from certain liabilities under the federal securities laws.[49]

In lockstep with these initiatives, the New York Stock Exchange, the National Association of Securities Dealers, and the American Stock Exchange have adopted new rules governing audit committees. These rules include:

- The audit committee is required to adopt formal written charters specifying in detail the scope of the committee's duties;[50] and

47 Securities and Exchange Commission Chairman Arthur C Levitt, Speech to the Economic Club of New York, New York City, 18 October 1999; Audit Committee Disclosure. See also Securities Act Release Number 33-7917; Exchange Act Release Number 34-4360 (21 November 2000), Exchange Act Release Number 34-42266 (22 December 1999); 64 Fed Reg 55, 648 (1999).

48 Not surprisingly, the Securities and Exchange Commission has asked for public comment on whether the audit committee charter should be reprinted in full or summarised in plain English.

49 Kreiger, 'Recent Developments in Audit Committees', *New York Law Journal*, 2 November 1999, at p 1.7.

50 New York Stock Exchange Listed Company Manual rule 303.01(B)(1); National Association of Securities Dealers Manual and Marketplace rules, rule 4350(d); and American Stock Exchange Listings Standards, Policies and Requirements, Part 1, s 121(B).

- The audit committee must consist of at least three 'independent directors'[51] — each member of the committee must be financially literate, and at least one member must have accounting experience or financial management expertise,[52] and the filer must annually certify that its audit committee is independent and is financially literate.[53]

Voting Rights. The New York Stock Exchange rule with respect to shareholder voting rights states that:

> . . . [v]oting rights of existing shareholders of publicly traded common stock registered under section 12 of the 1934 Act cannot be disparately reduced or restricted through any corporate action or issuance.

In its review of a company's eligibility for listing, the New York Stock Exchange will evaluate any unusual voting provisions associated with a company's securities.

Related-Party Transactions. The New York Stock Exchange believes that the review and oversight of transactions between a company and its officers and directors that might be perceived as conflicts of interest are best left to the discretion of the company.

However, the New York Stock Exchange expects corporations to discharge their responsibility in this area in an appropriate fashion. For this reason, companies applying to list on the New York Stock Exchange will be required to confirm that they will appropriately review and oversee related-party transactions on an ongoing basis. Although no particular method of oversight is dictated, the audit committee or another comparable body would be considered an appropriate forum.

American Stock Exchange

In General. The American Stock Exchange continues to operate as a separate, specialist-based auction market, like the New York Stock Exchange. Historically, the American Stock Exchange was the market for smaller companies than those listed on the New York Stock Exchange but, in recent years, its market and the number of its listed companies have eroded due to the success of the New York Stock Exchange in the fixed, physical location specialist based auction market favoured by 'blue chip' companies, and the success of the NASDAQ in the computer-based trading market favoured by 'technology' companies.

The American Stock Exchange has evolved to become a leader in offering markets for option trading and other derivative products. More than 900 issuers trade on the American Stock Exchange, as well as options on 28 broad-based and sector indexes. The American

51 New York Stock Exchange Listed Company Manual rule 303.01(B)(2)(a); National Association of Securities Dealers Manual and Marketplace rules, rule 4350 (d); and American Stock Exchange Listings Standards, Policies and Requirements, Part 1, s 121(B).

52 New York Stock Exchange Listed Company Manual rules 303.01(B)(2)(b), 303.01(B)(2)(c); see also National Association of Securities Dealers Manual and Marketplace rules, rule 4350(d), and American Stock Exchange Listing Standards, Policies and Requirements, Part 1, s 121(B).

53 New York Stock Exchange Listed Company Manual rule 303.02(C); see also National Association of Securities Dealers Manual and Marketplace rules, rule 4350(d), and American Stock Exchange Listing Standards, Policies and Requirements, Part 1, s 121(B).

Stock Exchange also is known for the trading of certain long-term equity anticipation securities (LEAPS) and Exchange Traded Funds (ETFs).[54]

Listing Requirements. To list on the American Stock Exchange, a non-United States company needs to satisfy one of two alternative financial guidelines and one of four distribution guidelines. The listing requirements for non-United States companies are as follows:

- Financial Guidelines — Alternative 1: Pre-tax income, US $750,000 in latest fiscal year or two of most recent three years; market value of public float, US $3 million; minimum price, US $3 per share; and stockholders' equity, US $4 million.
- Financial Guidelines — Alternative 2: Pre-tax income, not applicable; market value of public float, US $15 million; minimum price, US $3 per share; operating history of two years; and stockholders' equity, US $4 million.
- Distribution Guidelines — Alternative 1: Public float, 500,000 shares;[55] public stockholders in United States, 800; and average daily volume, not applicable.
- Distribution Guidelines — Alternative 2: Public float, 1 million shares; public stockholders in United States, 400; and average daily volume, not applicable.
- Distribution Guidelines — Alternative 3: Public float, 500,000 shares; public stockholders in United States, 400; and average daily volume, 2,000 shares.
- Distribution Guidelines — Alternative 4: Public float, 1 million shares; public stockholders, worldwide 800; and average daily volume, not applicable.

National Association of Security Dealers, Inc

In General. The National Association of Securities Dealers is the largest securities industry self-regulatory organisation in the United States, and it operates subject to oversight from the Securities and Exchange Commission. The National Association of Securities Dealers has two primary functions, namely to:

- Register, regulate, and oversee all of the broker-dealers in the United States; and
- Regulate and operate the over-the-counter market.

In 1996, the National Association of Securities Dealers, Inc, was formally restructured to create two separate, distinct, wholly owned subsidiaries of the National Association of Securities Dealers, Inc. The resulting structure includes National Association of Securities Dealers Regulation, Inc, the entity that is charged with the regulation, registration and oversight of broker-dealers, and the NASDAQ Stock Market, Inc, which is charged with the regulation of the over-the-counter stock markets.

54 American Stock Exchange, Press Release (2 November 1998). Additional information regarding the American Stock Exchange can be found at its web site, http://www.amex.com (1 April 2001).

55 'Public float' is defined as shares that are not held, directly or indirectly, by any officer or director of the issuer, or by any other person who is the beneficial owner of more than 10 per cent of the total shares outstanding.

As mentioned above, the NASDAQ Stock Market, Inc, is the largest electronic, screen-based market in the world. It is not a physical market like the New York Stock Exchange, but rather trades occur over computer systems from remote locations. It handles transactions involving over 1 billion shares a day. More than 4,829 companies are listed on NASDAQ, more than any other market.[56] The NASDAQ has two tiers, namely:

- The NASDAQ National Market System for larger companies; and
- The NASDAQ Smallcap Market for smaller, emerging growth companies.

The National Association of Securities Dealers, Inc, also has created NASDAQ International, a trans-Atlantic extension of NASDAQ that operates during normal London and European trading hours, 3:30 pm to 9 am Eastern Time, to provide trading services for NASDAQ National Market System companies, NASDAQ non-United States securities (except Canadian), American Depository Receipts, and equity securities listed on United States securities exchanges. This office also assists non-United States companies in accessing the United States capital markets and in gaining a listing on NASDAQ.

National Market. To qualify for listing on the NASDAQ National Market, a security of a non-United States issuer, or an American Depository Receipt or similar security issued in respect of a security of a non-United States issuer, must either be already registered and traded on another exchange or market pursuant to the 1934 Act[57] or be a new issue where the offering is conducted on a firm or best-efforts commitment basis. If on a firm-commitment basis, the securities of the issuer will be considered for inclusion on the day that its registration statement is declared effective by the Securities and Exchange Commission.

If on a best-efforts commitment basis, the securities of the issuer will be considered for inclusion on the closing of the offering. If a new issue, qualification will automatically terminate 120 days after the last day of the issuer's fiscal year during which the issuer's registration statement became effective. The three alternative listing requirements for the NASDAQ National Market,[58] which are applicable both to non-United States and United States companies, are as follows:

- Alternative 1: Net tangible assets, US $6 million;[59] pre-tax income, US $ 1 million in latest fiscal year or two of last three fiscal years; public float, 1.1 million shares; market value of public float, US $8 million; minimum bid price, US $5; shareholders (round-lot holders), 400; and market makers, three.[60]
- Alternative 2: Net tangible assets, US $18 million; public float, 1.1 million shares; operating history, two years; market value of public float, US $18 million; minimum bid price, US $5; shareholders (round-lot holders), 400; and market makers, three.

56 1999 National Association of Securities Dealers Annual Report.
57 Securities and Exchange Act of 1934, 15 United States Code, s 78l.
58 National Association of Securities Dealers' Manual, Marketplace rules, rules 4300–4400 *et seq*.
59 'Net tangible assets' means total assets, excluding goodwill, minus total liabilities.
60 A NASDAQ 'market maker' is a dealer that, with respect to a security, holds itself out as being willing to buy and sell such security for its own account on a regular and continuous basis, and that is registered as such.

- Alternative 3: Market capitalisation, US $75 million; or total assets, US $75 million; and total revenue, US $75 million; public float, 1.1 million shares; market value of public float, US $20 million; minimum bid price, US $5; shareholders (round-lot holders), 400; and market makers, four.

Corporate Governance. Under any of these three alternatives, a corporation applying for listing must agree to certain corporate governance requirements. The listing requirements can be flexible, given the requirements of the local rules under which the corporation operates.

The National Association of Securities Dealers provides that no provision of its listing requirements 'will be construed to require any [non-United States] issuer to do any act that is contrary to a law, rule, or regulation of any public authority exercising jurisdiction over such issuer or that is contrary to generally accepted business practices in the issuer's country of domicile. NASDAQ shall have the ability to provide exemptions from the applicability of these provisions as may be necessary or appropriate to carry out this intent'.[61] This rule particularly applies to the corporate governance provisions where corporate behaviour is mandated.

Distribution of Annual Reports. Each issuer is required to distribute to shareholders copies of an annual report containing audited financial statements of the company and all of its subsidiaries.

The report is required to be distributed to shareholders a reasonable period of time prior to the company's annual meeting of shareholders. The report also must be filed with NASDAQ at the time it is distributed to shareholders.

Distribution of Interim Reports. Each issuer is required to make available copies of quarterly reports, including statements of operating results to shareholders either prior to, or as soon as practicable, following the company's filing of its quarterly report with the Securities and Exchange Commission,[62] except that 'foreign private issuers'[63]

61 National Association of Securities Dealers' Manual, Marketplace rules, rule 4320.

62 Form 10-Q for domestic issuers.

63 The term 'foreign private issuer' is defined as: any foreign issuer other than a foreign government except an issuer meeting the following conditions: (a) More than 50 per cent of the issuer's outstanding voting securities are directly or indirectly held owned of record by residents of the United States; and (b) Any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 per cent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States. Instructions to paragraph (c)(1): to determine the percentage of outstanding voting securities held by United States residents: (a) use the method of calculating record ownership in rule 12g3-2(a) under the 1934 Act (section 240.12g3-2(a)); (b) unless information provided by the depositary demonstrates otherwise, count the holders of American Depositary Receipts as United States holders of the underlying securities; and (c) count shares of voting securities beneficially owned by residents of the United States as reported on reports of beneficial ownership provided to you or filed publicly and based on information otherwise provided to you. (Securities Act Release 7745; Exchange Act Release 41936; International Series Release 1205 (October 1999). The reference to rule 12g3-2(a) under the 1934 Act (s 240.12g3-2(a)) requires the issuer to 'look through' the record ownership of brokers, dealers, banks or nominees holding securities for the accounts of their customers to determine the residency of those customers' (International Series Release 1205).

do not need to file quarterly reports with the Securities and Exchange Commission and, therefore, do not need to file interim reports.

Independent Directors. Each issuer is required to maintain a minimum of three independent directors on its board of directors.

Audit Committee. Each issuer is required to establish and maintain an audit committee, a majority of the members of which must be independent directors.[64]

Shareholder Meetings. Each issuer is required to hold an annual meeting of shareholders and must provide advance notice of such meeting to NASDAQ.

Quorum. Each issuer must provide for a quorum as specified in its by-laws for any meeting of the holders of common stock; however, in no case may such quorum be less than one-third of the outstanding shares of the company's common voting stock.

Conflicts of Interest. Each issuer is required to conduct an appropriate review of all related-party transactions on an ongoing basis and to utilise the company's audit committee, or another comparable committee composed of members of the board of directors, for the review of potential conflict of interest situations where appropriate.

Shareholder Approval. Each issuer must require shareholder approval of a plan or arrangement under sub-paragraph (A) below or, prior to the issuance of certain securities, under sub-paragraph (B), (C), or (D) below:

> (A) when a stock option or purchase plan is to be established or other arrangement made pursuant to which stock may be acquired by officers or directors, except for warrants or rights issued generally to security holders of the company or broadly based plans or arrangements including other employees (eg, employee stock ownership plans);[65]
>
> (B) when the issuance will result in a change of control of the issuer;
>
> (C) in connection with the acquisition of the stock or assets of another company if: (a) any individual director, officer, or substantial shareholder of the issuer has a five per cent or greater interest (or such persons collectively have a 10 per cent or greater interest), directly or indirectly, in the company or assets to be acquired or in the

64 Like the New York Stock Exchange, companies listing on NASDAQ will be subject to the recently modified regulations regarding audit committees.

65 In a case where the shares are issued to a person not previously employed by the company, as an inducement essential to the individual's entering into an employment contract with the company, shareholder approval will generally not be required. Where the establishment of a plan or arrangement under which the amount of securities which may be issued does not exceed the least of: (a) one per cent of the number of shares of common stock, (b) one per cent of the voting power outstanding, or (c) 25,000 shares, shareholder approval will generally not be required.

consideration to be paid in the transaction, or series of related transactions, and the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, could result in an increase in outstanding common shares or voting power of five per cent or more, or (b) where, due to the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, other than a public offering for cash: (i) the common stock has, or will have on issuance, voting power equal to or in excess of 20 per cent of the voting power outstanding before the issuance of stock or securities convertible into or exercisable for common stock, or (ii) the number of shares of common stock to be issued is or will be equal to or in excess of 20 per cent of the number of shares of common stock outstanding before the issuance of the stock or securities; or

(D) in connection with a transaction other than a public offering involving: (a) the sale or issuance by the issuer of common stock, or securities convertible into or exercisable for common stock, at a price less than the greater of book or market value which together with sales by officers, directors, or substantial shareholders of the company, equals 20 per cent or more of common stock or 20 per cent or more of the voting power outstanding before the issuance, or (b) the sale or issuance by the company of common stock, or securities convertible into or exercisable for common stock, equal to 20 per cent or more of the common stock or 20 per cent or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock. Exceptions may be made on application to NASDAQ when the delay in securing stockholder approval would seriously jeopardise the financial viability of the enterprise and reliance by the company on this exception is expressly approved by the audit committee or a comparable body of the board of directors.[66]

Voting Rights. A company may not:

- Take corporate action to impose any restriction on the voting power of shares of the common stock of the issuer held by a beneficial or record holder based on the number of shares held by such beneficial or record holder;
- Take corporate action to impose any restriction on the voting power of shares of the common stock of the issuer held by a beneficial or record holder based on the length of time such shares have been held by such beneficial or record holder;
- Make any issuance of securities through an exchange offer by the issuer for shares of an outstanding class of the common stock of the issuer, in which the securities issued have voting rights greater than or less than the per share voting rights of any outstanding class of the common stock of the issuer; or
- Make any issuance of securities pursuant to a stock dividend, or any other type of distribution of stock, in which the securities issued have voting rights greater than the per share voting rights of any outstanding class of the common stock of the issuer.

Listing Agreement. Each issuer must execute a listing agreement in the form designated by NASDAQ.

66 A company relying on this exception must mail to all shareholders not later than 10 days before issuance of the securities a letter alerting them to its omission to seek the shareholder approval that would otherwise be required and indicating that the audit committee of the board or a comparable body has expressly approved the exception.

Peer Review of Accountant. Each issuer must be audited by an independent public accountant that:

- Has received an external quality control review by an independent public accountant that determines whether the auditor's system of quality control is in place and operating effectively and whether established policies and procedures and applicable auditing standards are being followed; or
- Is enrolled in a peer review program and within 18 months receives a peer review that meets acceptable guidelines.

Such guidelines are that:

- The peer review should be comparable to the standards of the American Institute of Certified Public Accountants (AICPA) included in 'Standards for Performing on Peer Reviews', codified in the American Institute of Certified Public Accountants Securities and Exchange Commission Practice s Reference Manual;
- The peer review program should be subject to oversight by an independent body comparable to the organisational structure of the Public Oversight Board as codified in the American Institute of Certified Public Accountants Securities and Exchange Commission Practices Reference Manual; and
- The administering entity and the independent oversight body of the peer review program must, as part of their rules of procedure, require the retention of the peer review working papers for 90 days after acceptance of the peer review report and allow NASDAQ access to those working papers.

Solicitation of Proxies. Each issuer is required to solicit proxies and provide proxy statements for all meetings of shareholders and to provide copies of such proxy solicitations to NASDAQ.

For each of the above corporate governance requirements, the non-United States issuer may send a 'request for exemption' to the NASDAQ Listing and Qualification Department, requesting an exemption from a specific requirement, if such requirement is not required in the home country of the issuer.[67] The non-United States company is exempt from the federal regulation of proxy solicitation under section 14 of the 1934 Act by virtue of rule 3a12-3(b).[68]

NASDAQ SmallCap Market Listing. To qualify for listing on the NASDAQ SmallCap Market, a security of a non-United States issuer, an American Depository Receipt, or similar security issued in respect of a security of a non-United States issuer, must either be already registered and traded on another exchange or market pursuant to the 1934 Act[69] or be a new issue where the offering is conducted on a firm-commitment or best-efforts commitment basis.

67 National Association of Securities Dealers' Manual, Marketplace rules, rule 4460(a).
68 17 Code of Federal Regulations, s 240.3a12-3.
69 Securities and Exchange Act of 1934, 15 United States Code, s 78l(g).

If on a firm-commitment basis, the securities of the issuer will be considered for inclusion on the day that its registration statement is declared effective by the Securities and Exchange Commission. If on a best-efforts commitment basis, the securities of the issuer will be considered for inclusion on the closing of the offering. If a new issue, qualification for listing will automatically terminate 120 days after the last day of the issuer's fiscal year during which the issuer's registration statement became effective.

The listing requirements for listing on the NASDAQ SmallCap Market[70] are as follows:

- Net tangible assets — US $4 million; or market capitalisation, US $50 million; or net income, US $750,000 in the latest fiscal year or two of the last three fiscal years; and
- Public float — 1 million shares;
- Market value of public float — US $5 million;
- Minimum bid price: US $4;
- Shareholders (round-lot holders) — 300; and
- Market makers — three.

In addition, a corporation with an operating history of less than one year must have a market capitalisation of US $50 million or more.

OTC Bulletin Board

The National Association of Securities Dealers also operates and oversees the OTC Bulletin Board, which is an electronic, screen-based market for securities that are not listed on NASDAQ or any United States stock exchange. The OTC Bulletin Board is an alternative for stocks that cannot meet the listing requirements on an established stock exchange or market or that are very thinly traded. To be listed on the OTC Bulletin Board, a company must be:

- Registered pursuant to the Exchange Act, or otherwise be subject to the requirement to file periodic reports with the Commission; and
- Current in its filings with the Securities and Exchange Commission.

If the company does not make a timely filing, it will be given 30 or 60 day grace period, depending on the type of company, to file the late reports. If the report is still not filed by the end of the grace period, quotations of the company's securities will not be allowed.

The OTC Bulletin Board captures and displays bid and asked quotations and unpriced indications of interest. All priced quotations on domestic stocks are entered by market makers and must be firm for a minimum size, based on the price of the security. All prices for domestic stocks can be continuously updated. For non-United States stocks and American Depository Receipts, quotations can be updated twice a day.

70 National Association of Securities Dealers' Manual, Marketplace rules, rule 4310; National Association of Securities Dealers web site, http://www.nasdaq.com (1 April 2001).

Pink Sheets

Another alternative for securities of an issuer which do not qualify for listing on an exchange or market, but still have an active market interest, is a quote service provided by Pink Sheets LLC ('Pink Sheets'), which was formerly known as the National Quotation Bureau (NQB), to brokers and dealers. A non-United States issuer may list on the Pink Sheets:

- As a result of not qualifying for an exchange or market;
- Through a lack of resources or insolvency; or
- As a result of being de-listed from an exchange or market.

The Pink Sheets originally listed these over-the-counter transactions on a daily basis and were printed on pink paper. However, they are now tracked both electronically and via print products, on a real-time basis. Due to an increase in the number of issuers delisted or dropped by the OTC Bulletin Board, the Pink Sheets have expanded its quotation service and has recently instituted real-time pricing. It is anticipated that these services will bring more liquidity and more transparency to these markets.

Alternative Trading Systems

In addition, as of April 1999, registered broker-dealers may set up private alternative trading systems, rather than registering as a national securities exchange, so long as they comply with Regulation ATS. If the alternative trading system trades less than five per cent of the trading volume in all securities that it trades, it only needs to file with the Securities and Exchange Commission a notice of operation and quarterly statements and:

- Maintain records, including an audit trail of transactions; and
- Refrain from using the words 'exchange', 'stock market', or other similar terms in its name.

On the other hand, an alternative trading system with five per cent or more of the trading volume of any security that chooses to register as a broker-dealer — instead of as an exchange — must be linked to a national market systems securities exchange and comply with the obligations that govern registered exchanges. Furthermore, any alternative trading system registered as a broker-dealer must meet even more stringent requirements concerning its standards and procedures.

Among these recent developments are regulatory challenges resulting from increased use of, and activity by, Electronic Communication Networks (ECNs). These are private trading systems where the ECN matches two subscribers' orders, and charge each participant a fee for actions as their agent in the transaction. While ECNs certainly enhance the market's liquidity, the Securities and Exchange Commission is currently monitoring and contemplating regulation to address fairness issues and other challenges caused by the applicable fees and accessibility of the ECN markets.[71]

71 Testimony of Securities and Exchange Commission Chairman Arthur Levitt concerning market structure issues currently facing the Securities and Exchange Commission, before the United States Senate Committee on Banking, Housing, and Urban Affairs, 27 October 1999.

PORTAL Market

Simultaneously with the adoption of rule 144A,[72] which provides for the resale of certain restricted securities of large companies to qualified institutional buyers, the Securities and Exchange Commission approved the National Association of Securities Dealers' Private Offering, Resale, and Trading Through Automated Linkages (PORTAL) System.[73]

PORTAL is a trading system designed to establish automated trading, clearance, and settlement facilities for primary placements and secondary trading of unregistered securities to qualified institutional buyers through the International Securities Clearing Corporation, Depository Trust Company, and Centrale de Livraison de Valeurs Mobilieres, SA, Luxembourg. PORTAL also provides facilities for primary placements of rule 144A securities.

Public Offerings by Foreign Issuers

In General

The United States has historically been a strong advocate of international commerce and the unfettered international movement of goods, services, and capital. Now, here is the advocacy more apparent than in the accessibility of the growing United States capital markets to non-United States companies. As evidence, non-United States companies' participation in the United States public market continued to show strong growth in 1999.

During 1999, approximately 120 foreign companies from over 26 countries entered the United States public markets for the first time, resulting in more than US $244 billion registered by non-United States companies for public offerings. In total, at year-end 1998, there were nearly 1,200 non-United States companies from 57 countries filing reports with the Securities and Exchange Commission.[74]

To be a participant in these explosive markets, non-United States companies offering their securities to United States persons are generally subject to United States securities laws in the same manner as their counterpart United States domestic issuers[75] except that, in certain circumstances, the domestic disclosure requirements have been altered to fit a typical foreign company profile.[76]

Thus, a non-United States issuer proposing to make a public offering of securities in the United States must register the offering under the 1933 Act,[77] and market trading must be conducted under the 1934 Act,[78] but the disclosure requirements have been altered to fit an international context.

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72 17 Code of Federal Regulations, s 230.144A.
73 Exchange Act Release Number 27956 (27 April 1990).
74 1999 Securities and Exchange Commission Annual Report.
75 15 United States Code, s 77b.
76 For example, the non-United States company is exempt by virtue of rule 3a12-3(b) from the proxy solicitation requirements of section 14 of the 1934 Act, 17 Code of Federal Regulations, s 240.3a12-3.
77 Securities Act of 1933, 15 United States Code, s 77f.
78 Securities and Exchange Act of 1934, 15 United States Code, s 778b.

A non-United States issuer proposing to make a public offering of securities in the United States must register the offering under the 1933 Act,[79] and market trading must be conducted under the 1934 Act.[80]

The securities regulatory system in the United States does not register companies; rather, the regulatory system focuses on the type of transaction, regardless of whether it is a private or public transaction, and the actual securities sold or traded. An initial public offering in the United States is a distribution where a once privately owned company transforms itself into a publicly held one by selling its securities to the public. Before selling its securities to the public, the registrant must:

- Register the shares and the distribution by filing a registration statement with the Securities and Exchange Commission in accordance with the rules and regulations of the Securities and Exchange Commission;
- Gain effectiveness for the registration statement; and
- Close the purchase and sale.

Usually, this transaction is conducted through one or more lead underwriters[81] that organise a syndicate of underwriters to sell the securities to the public.

Often, in today's market, there will be a domestic and international offering initiated simultaneously using the same disclosure document. Once an initial public offering has become effective or closed, a trading market in the United States may be commenced by registering such securities under the 1934 Act.[82] In furtherance of the precepts of registration, the 1934 Act promulgates an on-going duty to periodically disclose certain material business and financial information to the broker-dealer community and the investing public.[83]

Foreign issuers must comply with the registration provisions of the federal securities laws, including the presentation of financial statements in accordance with United States generally accepted accounting principles ('United States GAAP').

Foreign private issuers with little or no experience in United States capital markets should be aware of the requirements of the public and private markets in the United States and the advantages and disadvantages related to becoming a publicly traded company in the United States.

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79 15 United States Code, s 77f.
80 15 United States Code, s 778b.
81 An 'underwriter' is defined as a person who has purchased from a issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking. 15 United States Code, s 77b(11).
82 15 United States Code, s 781.
83 15 United States Code, s 78m.

Definition of a Foreign Private Issuer

In General

The Securities and Exchange Commission has provided an integrated disclosure system for 'foreign private issuers' that is different from the requirements for domestic issuers. One of the major elements of the recently enacted changes is the amendment to rule 405 under the Securities Act and rule 3b-4 under the Exchange Act to include a revised definition of 'foreign private issuer'. Due to increased prevalence of offshore nominees and custodial accounts, the Securities and Exchange Commission wants to see a clearer picture of a company's ownership. As such a 'foreign private issuer'[84] is now defined as:

> . . . any foreign issuer other than a foreign government except an issuer meeting the following conditions: (1) More than 50 per cent of the issuer's outstanding voting securities are directly owned of record by residents of the United States; and (2) Any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; and (ii) more than 50 per cent of the assets of the issuers are located in the United States; or (iii) the business of the issuer is administered principally in the United States . . . .

Instruction to Paragraph (c)(1)

To determine the percentage of outstanding voting securities held by United States residents:

> (A) Use the method of calculating record ownership in rule 12g3-2 (a) under the 1934 Act (section 240.12g3-2(a)); (B) Unless information provided by the depositary demonstrates otherwise, count the holders of American Depositary Receipts as United States holders of the underlying securities; and (C) Count shares of voting securities beneficially owned by residents of the United States as reported on reports of beneficial ownership provided to you or filed publicly and based on information otherwise provided to you. (Securities Act Release 7745; Exchange Act Release 41936; International Series Release 1205 (28 September 1998)).

The reference to rule 12g3-2(a) under the 1934 Act (section 240.12g3-2(a)) requires the issuer 'to "look through" the record ownership of brokers, dealers, banks, or nominees holding securities for the accounts of their customers to determine the residency of those customers'.[85]

If an issuer is a foreign private issuer, the United States securities laws prescribe a different set of requirements, generally encompassing the following:

- Interim reporting must be on the basis of the foreign private issuer's home country and stock exchange practice; quarterly reports are not mandated for foreign private issuers, as opposed to domestic issuers, except that many foreign private issuers nonetheless provide interim information to comply with their trading obligations on stock exchanges or markets.

84 17 Code of Federal Regulations, s 230.405, or 17 Code of Federal Regulations, s 240.3b-4(c).

85 International Series Release 1205.

- Foreign private issuers are exempt from the proxy solicitation requirements of section 14 of the 1934 Act,[86] and the short swing trading restrictions of section 16 of the 1934 Act,[87] and the short swing trading restrictions of section 16 of the 1934 Act applicable to domestic issuers.[88]
- Foreign private issuers are not required to disclose executive compensation on an individual basis, but they may instead disclose on an aggregate if so permitted in a foreign issuer's home country.[89]

Advantages and Disadvantages of Going Public in the United States

Advantages

Access to Capital. One of the main advantages of going public in the United States is access to capital at a potentially attractive evaluation or multiple of earnings based on the type of company, its historical earnings and growth, and its future business plan.

An initial public equity offering can bring considerable proceeds to a company. Subsequently, the public company can return to the market for additional capital through secondary equity offerings.

Listing. In addition, a public offering is one method to provide for the listing of the securities of a non-United States company on a stock exchange or market. The creation of a public market is intended to result in increased liquidity of the holdings of the principal owners, as well as minority shareholders, allowing a sale of shares to quickly be converted to cash.

This is especially true for non-United States issuers who may value the ability to have liquidity outside of their home market in United States dollars.

New Currency. A public offering also results in the establishment of a new currency in the company, which represents the market's perception of the company's value. A company then has increased flexibility to facilitate future financing and merger and acquisition possibilities.

The company whose stock is publicly traded may be in a better position to acquire other companies through a business combination transaction using its own shares as consideration, in lieu of cash, for the shares of the target company.

Sale of Shares. In addition, the company, with the co-operation of the issuer, founders, directors, and officers, may be able to sell its shares, which were acquired in private transactions, as 'selling stockholders' at either the initial public offering stage or in subsequent offerings.

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86 United States Code, s 78n.
87 15 United States Code, s 78p.
88 17 Code of Federal Regulations, s 240.3a12-3 (B).
89 Item 6B of Form 20-F.

Moreover, publicly traded stock, as opposed to private company equity interests, may provide shareholders with greater liquidity on death.

Once the public market has been created by the initial primary offering, existing shareholders are able to sell their shares in the liquid trading market subject to Commission rules on sales of restricted securities.[90]

Stock Options. In addition, an issuer may be in a better position to attract employees by offering stock options and an employee stock ownership plan when the underlying stock is publicly traded.

Prestige. Another possible positive by-product of going public in the United States is that the company gains prestige and publicity among the general investing public, thus giving the issuer a more favourable image, increasing good will, and perhaps putting it in a competitive advantage over a privately held competitor who is not required to disclose information to the public. Consumers are able to 'own' the company whose products and services they use.

Disadvantages

Compliance. However, the privilege of access to United States public markets and use of United States markets and exchanges brings with it the obligation to comply with the United States securities laws. Foreign issuers coming into United States markets should appreciate the fact that the Securities and Exchange Commission takes the enforcement of these laws very seriously.

The activism of the Securities and Exchange Commission in promoting fair and full disclosure of information and enforcing penalties and sanctions against fraudulent conduct is a very significant factor in creating investor confidence in United States markets.

Disclosure. Full public disclosure is one of the main burdens of going public. On the effectiveness of its initial registration statement with the Securities and Exchange Commission, the issuer becomes subject to the annual and periodic reporting requirements and other requirements of the 1934 Act. The disclosure, accounting, and reporting requirements imposed by the Securities and Exchange Commission are far more stringent than those of other nations.[91]

In addition, as discussed above, the stock exchanges and markets require immediate public disclosure of 'any significant event that could affect an investor's decision to buy, sell, or hold the company's stock'.[92]

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90 17 Code of Federal Regulations, s 240.144.

91 Schimkat, 'The Securities and Exchange Commission's Proposed Regulations of Foreign Securities Issued in the United States', 60 *Fordham L Rev* (1992), at p S203.

92 Hoyns and Kanter, 'Deciding Whether to Go Public', *PLI*, *How to Prepare an Initial Public Offering* (1999) at p 15.

The initial prospectus and subsequent Commission filings will reveal a significant amount of material business and financial information about the company that would not be available about a private company. This information provides competitors with a view of the company that they would not otherwise have. Included are descriptions of the issuer's business, business strategies, material contracts, and information on every business subsidiary. This disclosure, including proposed corporate actions, will be subject to the scrutiny of the investment community, shareholders, and security regulators.

Inaccurate or selective disclosure may be a source of litigation. In fact, this topic has become a 'hot button' item for Securities and Exchange Commission rule making, as evidenced by the recent enactment of Regulation FD (Fair Disclosure) which imposes new restrictions on the disclosure of material non-public information.[93] Another result of an offering is the immediate dilution of an existing shareholder's holdings. For those shareholders (or employees or directors) that have invested their time, effort, and money into a growing company, a public offering will dilute or reduce their ownership interest.

Costs. In addition, offering costs required for a public offering of securities — underwriters, legal, accounting, printing, transfer agents, stock exchange listing, and state blue sky fees — may be substantial and will reduce the proceeds of the offering to the company. The company runs the risk that the offering will not be consummated, causing the company to incur all the fees without any guarantee of a result.

Compliance with the reporting requirements under the 1934 Act will be a significant yearly administrative cost and an ongoing onerous task. The task of registration and periodic reports will require a substantial amount of management's time and effort.[94]

Management. Once an issuer has offered its shares to the public, the relationship between the company's managers, directors, and controlling shareholders to its shareholders is altered.

Having publicly traded securities changes the focus of the company, which must thereafter be continually focused on relationships with its shareholders and the public perception of the company, including the disclosure of announcements and responding to the inquires of analysts. As a result of the pressures imposed by market forces, management of a publicly traded company may feel pressure to focus on short-term maximisation of profits at the expense of developing long-term goals.

Litigation Risk. Being a publicly traded company also subjects the company to increased litigation risk. The Securities and Exchange Commission has significant enforcement powers to deter fraudulent behaviour and to enforce compliance with United States law.

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93 17 Code of Federal Regulations, ss 243.100–243.103.

94 Hoyns and Kanter, 'Deciding Whether to Go Public', *PLI*, *How to Prepare an Initial Public Offering* (1999) at p 17.

In addition, United States law provides for private rights of action to enforce the regulatory system. As a result, the potential for litigation may influence role in the actions of a publicly traded company.

Liquidating Assets. Although an insider's investment in a public company will be more liquid than if the company were still private, control over liquidating that asset may be limited. One may not trade shares when in possession of non-public material information. In addition, there are periods when shares may not be traded due to possession of non-public information, such as at the time of earnings announcements, and periods when shares purchased in the public market may not be resold.

Selling by high-ranking insiders also can adversely affect market confidence in a company while buying sends a positive signal. Stock issued when the company was private may still be 'restricted' under Commission rules, even after the public offering, and thus subject to sale restrictions.[95]

Insider Trading. In recognition of the potential for abuse by people with access to non-public material information, the Securities and Exchange Commission has recently enacted Regulation FD and rules 10b5-1 and 10b5-2.

In response to the growing practice of issuers disclosing important non-public information, such as earnings warnings, to securities analysts or institutional investors before making this information to the general public, the Securities and Exchange Commission enacted Regulation FD. Regulation FD provides that when an issuer, or a person acting on behalf of an issuer, discloses material non-public information to a selective audience (eg, analysts and selective institutional investors), it must make public disclosure of that information, generally by making a filing on Form 8-K.[96]

Rule 10b5-1 of the Exchange Act[97] is intended to clarify the issue of when insider trading liability arises in connection with a trader's 'use' or 'knowing possession' of material non-public information. This rule provides that a person trades 'on the basis of' material non-public information when the person purchases or sells securities while aware of the information.

However, the rule also sets forth several affirmative defences that permit persons to trade in certain circumstances where it is clear that the non-public information was not a factor in the decision to trade.[98]

Rule 10b5-2 of the Exchange Act[99] addresses the issue of when a breach of a family or other non-business relationship may give rise to liability under the misappropriation theory

95 17 Code of Federal Regulations, s 240.144.
96 Securities Release Number 33-7881; Exchange Act Release Number 34-43154 (15 August 2000).
97 17 Code of Federal Regulations, s 240.10b5-1.
98 Securities Release Number 33-7881; Exchange Act Release Number 34-43154 (15 August 2000).
99 17 Code of Federal Regulations, s 240.10b5-2.

of insider trading. This rule sets forth three non-exclusive bases for determining that a duty of trust or confidence was owed by a person receiving information, and it will provide greater certainty and clarity on this unsettled issue.[100]

Non-United States Issuer Public Offerings in the United States

In General

Non-United States private issuers affecting an initial public offering in the United States must register the offering pursuant to the registration requirements of section 5 of the 1933 Act. Under section 5 of the 1933 Act, it is illegal to offer or sell securities in the United States without a registration statement declared effective by the Securities and Exchange Commission or pursuant to an exemption from registration.

Registration is intended to provide adequate and accurate disclosure of material facts concerning the company and the securities it proposes to sell, so that investors may make a realistic appraisal of the merits of the investment and make an informed investment decision. The Securities and Exchange Commission does not 'approve' or 'disapprove' the offering or exercise any investment judgment on behalf of investors. Any company may register its securities before the Securities and Exchange Commission — no matter the merits of the company, its management, and its prospects.

To this end, the Securities and Exchange Commission mandates registration forms for different types of companies, and it sets compulsory and extensive disclosure requirements and standards. The registration statement includes a prospectus, which is the document that will be provided directly to investors. All registration statements and prospectuses filed with the Securities and Exchange Commission are public documents and are available for inspection and copying at the offices of the Securities and Exchange Commission or through EDGAR, the on-line database of reporting companies and their filings.[101]

Registration Forms

In General. Currently, there are four registration forms (F-1, F-2, F-3, and F-4) that can be used to register the securities of a foreign private issuer for a public offering in the United States under the Securities Act. They essentially parallel Registration Forms S-1 through S-4, which are used by United States companies. In addition, Form F-6 is available to register American Depositary Receipts of non-United States issuers (see text, below).

Certain recent revisions effecting international disclosure standards, specifically those modifications to Form 20-F, which governs certain registration requirements, have impacted the application and caused a revision of those forms used for registration under the 1933 Act.

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100 Securities Release Number 33-7881; Exchange Act Release Number 34-43154 (15 August 2000).

101 EDGAR, at the Securities and Exchange Commission web site http://www.sec.gov/edgar.

Effective Dates and Transition Periods. In light of the recent revisions, the Securities and Exchange Commission disallowed any 'grandfathered' exemptions to these revised rules which became effective on 30 September 2000, with certain exemptions.[102] In some cases, as explained below, the date at which a registrant will have to comply with a revised form will depend on that registrant's fiscal year end.

Registration Statements Filed on Form F-1, Form F-4, or Form 20-F. Registrants (those non-United States entities that have registered with the Securities and Exchange Commission) must use revised Form F-1 and revised Form 20-F for registration statements first filed on or after 30 September 2000.

Registrants that are not eligible to incorporate Form F-4 information by reference to a previously filed annual report on Form 20-F also must use revised Form F-4 for registration statements filed on or after 30 September 2000.

Registration Statements Filed on Forms F-2 and F-3 and Form F-4 if It Permits Incorporation by Reference. Forms F-2l, F-3, and Form F-4 permit a registrant to satisfy form requirements by incorporating information from an annual report on Form 20-F. Form F-4 also permits the registrant to incorporate information about the other party to a business combination by referring to that company's annual report.

The revised Forms F-2, F-3, and F-4 do not provide for incorporation of information by reference to 'old' Form 20-F. Accordingly, the revisions to Forms F-2 and F-3 will be effective for registration statements and post-effective amendments filed any time after a registrant is required to file its first annual report on revised Form 20-F. In cases where a Form F-4 permits information about either party to the business combination to be incorporated by reference to an annual report on Form 20-F, the revisions to Form F-4 will be effective for registration statements and post-effective reference is required to file its first annual report on Form 20-F.

Annual Reports Filed on Form 20-F. Revised Form 20-F must be used for annual or transition reports filed with respect to fiscal years ending on or after 30 September 2000.

The following information applies to situations where the registrants make the transition from the old version of a form to the revised version:

- Pre-effective amendments — When, on 30 September 2000, a foreign private issuer has on file at the Securities and Exchange Commission a registration statement on Form F-1, a Form F-4 that does not permit incorporation by reference, or Form 20-F and that registration statement has not been declared effective, the issuer may continue to file pre-effective amendments to that registration statement after 30 September 2000 without modifying those pre-effective amendments to reflect the revisions. This position does not apply to pre-effective amendments to registration statements on Form

102 Securities Act Release Number 7745, Exchange Act Release Number 41936, International Series Release Number 1205 (28 September 1999).

F-2, Form F-3, or a Form F-4 that permit incorporation by reference because registrants will have a lengthy transition period and experience preparing an annual report on revised Form 20-F before they must comply with the revisions to those Securities Act registration statements.

- Post-effective amendments — The revisions to these registration statement forms apply to post-effective amendments filed on or after the effective date given above for a particular form if the post-effective amendment is to include the registrant's latest audited financial statements or to update the prospectus under section 10(a)(3).
- Registration statements and post-effective amendments filed under rule 462(b) and (c) — Registration statements and post-effective amendments filed under rule 462(b) and (c) are effective on filing with the Securities and Exchange Commission. These registration statements and amendments must comply with the registration statement revisions only if the registrant first filed the underlying registration statement on or after the effective date given above for a particular form.
- Prospectus supplements — The revisions to the newly adopted registration statement forms apply to prospectus supplements filed on or after the effective date given above for a particular form. If an issuer filed a base prospectus under rule 415(a)(1)(x) before it was required to comply with revised Form F-3, that base prospectus does not need to be amended, even though subsequent prospectus supplements must comply with the revised form.

Description of Registration Forms

Form F-1. Form F-1 is the basic registration form for public offerings by a foreign private issuer. Forms F-2, F-3, and F-4 are mainly used by non-United States companies to register secondary offerings of securities after the company has registered one or more of its classes of securities and has issued periodic reports pursuant to the 1934 Act. Form F-1 has the same information requirements as Forms F-2 and F-3, except that all information must be included in the document rather than incorporated by reference, thus resulting in a larger, more extensive document.[103]

The majority of first-time foreign private issuer registrants utilise the registration statement on Form F-1, since the issuers generally do not qualify for the other forms due to a lack of history as mandated by the reporting obligations of the 1934 Act. The disclosure requirements under Form F-1 are very similar to the disclosure obligations of a United States issuer on Form S-1. Information required under Form F-1 includes:

- Description of the securities to be offered;
- Pending legal proceedings;
- Risk factors;
- Use of proceeds;
- Determination of offering price;
- Dilution of selling security holders;

103 2 *Fed Sec L Rep* (CCH), paras 6952 and 6062.

- Plan of distribution;
- General information with respect to the registrant;
- Identity of directors and officers and their remuneration as a group;[104] and
- Audited financial statements prepared under, or reconciled with, United States GAAP.[105]

Unlike its Form S-1 counterpart, Form F-1 currently permits more limited disclosure in certain areas, including disclosure of the compensation and stock ownership of directors and management and transactions between the issuer and its directors and management.[106] In addition, certain disclosure requirements of Form F-1 are unique to the foreign private issuer registering a public offering. These include information regarding:

- The nature and extent of the principal non-United States trading market for the issuer's securities;
- Governmental regulations applicable to the issuer which restrict the import or export of capital or affect the remittance of dividends, interest, or other payments to security holders;
- Limitations on the right to hold or vote securities applicable to persons who are not citizens or residents of the issuer's home country;
- Taxes applicable to United States security holders under the laws of the country in which the issuer is organised and any applicable tax treaty; and
- Exchange rates between United States dollars and the home country currency.[107]

Form F-2. Form F-2, which may be used to register securities to be offered in a transaction other than an exchange offer for securities of another person, is available for a foreign private issuer that:

- Has been subject to 1934 Act reporting obligations for at least 36 months and has timely filed all required 1934 Act reports during the preceding 12 months; or
- Is subject to 1934 Act reporting obligations and has filed at least one annual report; or
- Has timely filed required 1934 Act reports during the last 12 months; and
- Has at least US $75 million in voting stock held by non-affiliates, or is registering non-convertible investment grade debt or preferred securities, or has been subject to 1934 Act reporting obligations for at least 12 months and is registering securities to be offered on exercise of outstanding transferable warrants or rights granted pro rata by

104 Generally, compare to Form S-1. Form S-1, which is used for domestic issuers, requires remuneration to be listed per director and officer in addition to in the aggregate; 17 Code of Federal Regulations, s 229.701.

105 Form F-1, 17 Code of Federal Regulations, s 239.31.

106 Form F-1, 17 Code of Federal Regulation, s 239.31. However, the recently adopted rules may impact on the issuer's disclosure regarding compensation and stock ownership. Securities Act Release Number 7745, Exchange Act Release Number 41936, International Series Release Number 1205 (28 September 1999).

107 Form F-1, 17 Code of Federal Regulations, s 239.31.

the issuer, pursuant to a dividend or interest re-investment plan or, on conversion of outstanding securities, has had no material default on loans or long-term leases or failure to pay a sinking fund instalment or dividend on preferred stock since the end of the last fiscal year covered by certified financial statements in its 1934 Act reports, and no subsidiary of the issuer has had such a default.[108]

Form F-2 requires similar information to the Form F-1. The difference is that the periodic reports must be delivered with the Form F-1 prospectus, while such documents may be incorporated by reference in the Form F-2.

Form F-3. Form F-3, used primarily for non-convertible debt offerings, may be used if the registrant's latest annual report filed with the Securities and Exchange Commission contains financial statements with full reconciliation to United States GAAP, and it is available with a reconciliation if the securities are non-convertible investment grade securities or are to be offered:

- In secondary offerings;
- On exercise of certain outstanding transferable warrants;
- On exercise of rights granted *pro rata* by the issuer to existing holders of such class;
- Pursuant to a dividend or interest re-investment plan; or
- On conversion of outstanding convertible securities.[109]

To be eligible to use Form F-3, the issuer must have:

- Securities registered under the 1934 Act, section 12(b) or section 12(g), or be required to file reports under the 1934 Act, section 15(d), and have filed at least one annual report;
- Been subject to the 1934 Act reporting obligations and filed all required materials on a timely basis for the last 12 months;
- Had no material default on loans or long-term leases or failure to pay a sinking fund instalment or dividend on preferred stock since the end of the last fiscal year covered by certified financial statements in its 1934 Act reports, and no subsidiary of the issuer may have had such a default; and
- Common stock held by non-affiliates with a market value of at least US $75 million, unless it is registering non-convertible investment grade securities to be offered for cash.[110]

An issuer using Form F-3 must provide a variety of information, including that relating to:

- The terms of the offering, including the use of proceeds;
- The latest and future Exchange Act annual reports and, if appropriate, reports on Form 6-K all of which are incorporated by reference;

108 Form F-2; 17 Code of Federal Regulations, s 239.32.
109 Form F-3; 17 Code of Federal Regulations, s 239.33.
110 Form F-3; 17 Code of Federal Regulations, s 239.33.

- Any material changes in its affairs since the latest annual report; and
- The financial statements of any business acquired or to be acquired.

Employing the same approach as a United States issuer's Form S-3, Form F-3 incorporates by reference the registrant's latest Form 20-F (see text, below) and otherwise generally requires only transaction-related data.[111]

Form F-4. Form F-4 is available for business combination transactions involving foreign private issuers.[112]

Other Forms. Forms F-7, F-8, F-9, F-10, and F-80 contain the abbreviated disclosure requirements available to qualifying non-United States companies under the multi-jurisdictional disclosure system.[113]

American Depository Receipts

In General

Foreign private issuers raising capital in the United States markets frequently elect to effect the offering utilising American Depository Receipts.[114] As previously described, an American Depository Receipt is a negotiable instrument issued by a third-party depositary, usually a United States bank or its non-United States affiliate, and it represents a specified number of securities of the underlying issuer which are held by the depositary on behalf of the American Depository Receipt holders.

Trades are typically affected in the American Depository Receipts themselves and not in the underlying securities. American Depository Receipts have been developed to alleviate certain legal restrictions and practical problems related to the trading in the underlying issuer of non-United States securities.

First, the American Depository Receipt is transferable on the books of the depositary bank without the need to affect a transfer of the underlying securities on the record books of the issuer. This allows quicker processing of transactions, can eliminate transfer taxes, and can reduce any practical problems with respect to non-United States exchange controls. In addition, the registration of American Depository Receipt holdings eliminates problems associated with non-United States equity securities, such as legal requirements that effectively restrict the ability of holders to vote shares.[115]

The depositary bank acts as the issuer's agent, notifying American Depository Receipt holders of dividend distributions, paying dividends to the American Depository Receipt

111 Form F-3; 17 Code of Federal Regulations, s 239.33.
112 Form F-4; 17 Code of Federal Regulations, s 239.34.
113 A full discussion of the multi-jurisdictional disclosure system and Canadian companies is provided later in this chapter.
114 American Depository Receipts are defined at 17 Code of Federal Regulations, s 230.405.
115 Zeprun, 'United States Public Offerings and Periodic Reporting by Foreign Issuers', 1018 *PLI*, *Corporate Finance* (1997) 695, at p 704.

holders (after converting the dividends to United States currency), and providing to the American Depository Receipt holders other information provided by the issuer to its shareholders, and voting on behalf of the American Depository Receipt holders.

American Depository Receipts may be traded on a United States stock exchange or NASDAQ if registered pursuant to section 12 of the 1934 Act and if they are current with their Securities and Exchange Commission filings. American Depository Receipts also may trade on the OTC Bulletin Board and Pink Sheets, assuming again that they are current with their Securities and Exchange Commission filings.

In most cases, an American Depository Receipt is a superior mechanism for trading the securities of non-United States issuers for the following reasons:

- The American Depository Receipt form of registration is more familiar to the United States investment community;
- The American Depository Receipt is generally easier for United States investors to understand rather than having to deal with the alternative of a foreign share certificate, which may be denominated in a foreign currency or may be in bearer form;
- The American Depository Receipt arrangement enhances transferability of stock certificates by avoiding the legal mandate of multiple jurisdictions, some of which may require an execution of a deed and an acknowledgment before a notary public to transfer securities, and/or might impose stamp or other transfer taxes on share transfers; and
- The American Depository Receipt can be issued in any ratio, such as one American Depository Receipt equals three underlying shares, which could be used to increase the price level of the shares to customary levels of equivalent United States securities or to satisfy minimum price requirements of a United States exchange or market.

Types of American Depositary Receipts

In General. American Depository Receipts generally take two forms, ie, 'unsponsored' and 'sponsored'.

An 'unsponsored' American Depository Receipt is typically created by a depositary bank acting on its own initiative in response to investor interest in a non-United States security. The bank establishes the arrangement, generally with the knowledge, but not the active co-operation, of the non-United States issuer.

Dividend distribution fees and other administrative costs are borne by the American Depository Receipt holders through the bank's retention of a portion of the dividend. The depositary is required to file a registration statement on the relatively simple Form F-6[116] and then may accept deposits of the issuer's securities and commence issuance of receipts against those deposits.

116 17 Code of Federal Regulations, s 239.36.

A 'sponsored' American Depository Receipt is created with the consent and assistance of the issuer of the underlying securities. The issuer typically enters into a deposit agreement with the depositary bank, setting forth the rights and obligations of the issuer, the depositary bank, and the holders of American Depository Receipts. The issuer will also sign the F-6 registration statement.[117] In a sponsored arrangement, the issuer typically bears the fees of the depositary.

There are three levels of sponsored American Depository Receipts, each requiring different registration and reporting procedures pursuant to the 1933 Act and the 1934 Act.

Level I American Depository Receipts. Level I American Depository Receipts trade on the OTC Bulletin Board and Pink Sheets, and they do not require the non-United States issuer to comply with United States GAAP or full Commission disclosure requirements, based on the exemption created by rule 12g3-2(c), provided that, to be quoted on the OTC Bulletin Board, the non-United States issuer is registered and current with its filing requirements.

Since Level I American Depository Receipts are not registered under section 12 of the 1934 Act, the issuer is prohibited from raising capital. The issuer of the American Depository Receipt must file on Form F-6, and the American Depository Receipt's underlying security must be registered or exempt from registration under the 1934 Act.

Level II American Depository Receipts. Level II American Depository Receipts are registered under section 12 of the 1934 Act, and thus are eligible to be listed on an exchange or market, but have not been offered to United States investors in a public offering. Level II registration requires filing on Form F-6 as well as on Form 20-F.

Level III American Depository Receipts. The Level III American Depository Receipt requires detailed disclosure about both the issuer and the securities being offered to the public but, unlike a Level II American Depository Receipt, registration of a Level III American Depository Receipt permits an issuer to raise capital through a public offering to United States investors as well as permitting the listing of the American Depository Receipts on a national exchange or market.

Registration of American Depository Receipts

Form F-6 may be used to register the shares evidenced by American Depository Receipts issued against the deposit of the securities of a non-United States issuer, and it may be used only if the issuer is filing periodic reports with the Securities and Exchange Commission under the 1934 Act or the deposited securities are exempt from such reporting by rule 12g3-2(b),[118] if the deposited securities are registered under the 1933 Act or exempt from such registration and if the American Depository Receipt holder is entitled to withdraw the deposited securities at any time, subject only to temporary delays for specified, limited reasons.

117 17 Code of Federal Regulations, s 239.36.
118 17 Code of Federal Regulations, s 240.12g3-2(b).

A main advantage of an American Depository Receipt is the relative simplicity of Form F-6 and that, pursuant to rule 15d-3,[119] annual and other reports are not required as a result of registering American Depository Receipts on Form F-6. American Depository Receipts also are exempt from registration under section 12(g) of the 1934 Act, pursuant to rule 12g3-2(c).[120]

To become listed on a United States exchange or market, American Depository Receipts must be registered pursuant to section 12 of the 1934 Act,[121] and a registration statement and annual reports must be filed on Form 20-F. Thus, a number of companies decide not to have their American Depository Receipts listed on an exchange or market. Instead they are listed as Level I American Depository Receipts, trading on the Pink Sheets or the OTC Bulletin Board services that provide limited quotation or transaction information but, in the case of the OTC Bulletin Board, still require the issuer to currently file reports with the Securities and Exchange Commission pursuant to section 13 or section 15(d) of the Exchange Act.

In July 1997, the Securities and Exchange Commission adopted rule 12a-8 to exempt American Depository Receipts that are listed on a national securities exchange and registered on Form F-6 from the registration requirements of section 12(b) of the 1934 Act.[122] Nevertheless, the section 12 registration requirements still apply to the class of securities underlying the American Depository Receipts.[123]

Financial Statements

In General. The Securities and Exchange Commission, through the activities of the Office of the Chief Accountant and private sector groups such as the Financial Accounting Standards Board and the American Institute of Certified Public Accountants, establishes and maintains stringent accounting standards for companies that avail themselves of the United States capital markets and exchanges.[124]

The Securities and Exchange Commission has recently adopted significant revisions to rules and regulations governing financial disclosure for new non-United States issuers.

Financial Statement Disclosure under Revised United States Disclosure Requirements. The International Organisation of Securities Commissions, of which the Securities and Exchange Commission is a member, developed international disclosure

119 17 Code of Federal Regulations, s 240.15d-3.
120 17 Code of Federal Regulations, s 240.12g3-2(c).
121 Securities and Exchange Act of 1934, 15 United States Code, s 781.
122 17 Code of Federal Regulations, s 240.12a-8; Securities Act Release Number 7431 (18 July 1997).
123 17 Code of Federal Regulations, s 240.12a-8; Securities Act Release Number 7431 (18 July 1997).
124 In connection with recent revisions to the rules and regulations governing financial disclosure that are discussed in detail later in this chapter, the Securities and Exchange Commission has issued a recent concept release seeking comments on the necessary elements of an effective, high-quality global financial-reporting framework, specifically, through the work of the International Accounting Standards Committee. For more information regarding these proposed issues, see Securities and Exchange Commission Concept Release, Securities Act Release 7801; Exchange Act Release 42430; International Series Release 1215 (16 February 2000).

standards that facilitate crossborder capital raising and listing by letting companies comply with one set of non-financial disclosure requirements for offerings in several jurisdictions.

The result of these efforts by International Organisation of Securities Commissions is a compilation of international disclosure standards, envisioned as an 'international passport' to the world's capital markets.[125] The International Organisation of Securities Commissions standards were endorsed by International Organisation of Securities Commissions in September 1998. These standards are the basis of the rulemaking revisions currently enacted by the Securities and Exchange Commission.[126]

A major facet of the Securities and Exchange Commission's recent revision is to modify and harmonise international disclosure standards by deleting rule 3-19 of Regulation S-X, replacing it with a new item 8 on Form 20-F. This provision will reduce the current permitted age of reconciled financial statements for foreign private issuers to conform to the proposed International Organisation of Securities Commissions standards.[127]

As mentioned above, the Securities and Exchange Commission has enacted new rules and regulations that significantly change the permitted age of financial statements. The new item 8 of Form 20-F will now mandate that audited financial statements will be no older than 15 months at 'the time of the offering or listing', which means the effective date of the registration statement, rather than the 18 months previously permitted by rule 3-19. For those issuers effecting registration under an initial public offering,[128] the audited financial statements must also be of a date not older than 12 months at the time the offering document is filed with the Securities and Exchange Commission.[129]

State Blue Sky Requirements

Non-United States issuers effecting an offering in the United States must also comply with the securities laws of the individual states in which the offering is conducted. Generally, state securities laws, or 'blue sky' laws, will be complied with by virtue of registration of the offering under the federal securities laws, provided that appropriate notices are filed in the various states.[130]

Following the amendment of certain aspects of the United States federal securities law under the National Securities Markets Improvement Act of 1996,[131] a security which

125 Securities Act Release 7637; Exchange Act Release 41014; International Series Release 1182 (4 February 1999).

126 Securities Act Release 7637; Exchange Act Release 41014; International Series Release 1182 (4 February 1999).

127 Securities Act Release 7637; Exchange Act Release 41014; International Series Release 1182 (4 February 1999).

128 This revised strict standard is not applicable to issuers that are publicly traded in their home country.

129 Securities Act Release Number 7745, Exchange Act Release Number 41936; International Series Release Number 1205 (28 September 1999).

130 An exception to this exemption from state securities laws is an offering that is exempt from registration pursuant to section 3(a)(10) of the Securities Act. To address a legislative anomaly, securities offered pursuant to this section are no longer deemed as 'covered securities' and as such the securities are not privy to the convenience of the National Securities Markets Improvement Act. Revised Staff Legal Bulletin Number 3 (CF), 20 October 1999.

131 National Securities Markets Improvement Act of 1996, Public Law Number 104-290 (1996).

trades on the New York Stock Exchange, American Stock Exchange, or the NASDAQ National Market is generally exempted from certain laws of the individual states.

Registration Process

In General. Once a company determines to register its shares with the Securities and Exchange Commission, to list the company's securities on the United States stock markets, and/or to raise capital in the United States through an initial public offering, the company should assemble a team of experts to assist with the preparation of a registration statement.

For initial public offerings, the non-United States issuer needs to select an investment banker experienced in this area. The company will formalise its relationship with the underwriter through a 'letter of intent' which outlines fees, ranges for stock price and number of shares, and certain other conditions.

Legal counsel for an entity undertaking an initial public offering should be familiar with the underwriting process and should be accustomed to dealing with the Securities and Exchange Commission, the National Association of Securities Dealers, and the state securities commissions regarding the prospectus submission process. The accountants should be certified public accountants whose work conforms to Securities and Exchange Commission Accounting Principles and United States GAAP.

Prospectus. As mentioned above, the prospectus is the key document of the registration document. The prospectus is both a disclosure document, by law, and a selling document, by custom, since it is the only information that the law allows to be disseminated about the offering. Usually, counsel is primarily responsible for drafting the narrative part of the prospectus, while the accounting firm will prepare the financial statements and the investment banker will supply the underwriting details.

Typically, the registration statement goes through many drafts and is extensively reviewed for its accuracy prior to filing with the Securities and Exchange Commission. During this process, counsel typically reviews information regarding the company and its business, its material contracts, its supply and customer relationships, and its management, compensation arrangements, and related-party transactions. Often, counsel will visit the client to review, first hand, its operations and properties. After a registration statement is drafted, it is then reviewed by the underwriter and its counsel.

In an effort to make disclosure more clear, concise, and understandable for investors, the Securities and Exchange Commission has recently adopted a 'Plain English' rule. To avoid extensive comments from the Securities and Exchange Commission, which results in a delaying of the Registration Statement being declared effective, issuers should draft the prospectus with an aim towards compliance with the Plain English mandate.[132]

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132 7 Code of Federal Regulations, s 230.421; Securities Act Release Number 7497; Exchange Act Release Number 39593; International Series Release Number 1113 (22 January 1998). More information regarding the plain English rule is available in the Securities and Exchange Commission's *A Plain English Handbook — How to Create Clear Securities and Exchange Commission Disclosure Documents*, which is available at the Securities and Exchange Commission's web site (www.sec.gov) or by calling 1-800-SEC-0330.

Underwriters occupy a unique position in United States securities law, and they must perform 'due diligence' on the company to meet their obligations under the United States securities law.

Once the company, its counsel, accountants, and advisors are satisfied with the registration statement, and the underwriter and its counsel are satisfied as well, the registration statement is filed with the Securities and Exchange Commission and the appropriate fee paid.

Commission Role. The Securities and Exchange Commission's role in the regulation of prospectuses focuses on disclosure. Within the Securities and Exchange Commission, the Division of Corporation Finance reviews the registration statement when it is filed for the accuracy and adequacy of all material facts — information that would affect investment decisions and compliance with the Securities and Exchange Commission's rules and forms. Unlike United States issuers, the Securities and Exchange Commission's Office of Corporate Finance, Division of International Corporate Finance, is willing to review, on a confidential basis, the disclosure documents of the non-United States issuers in draft form on a confidential non-public basis, if requested by the non-United States issuer.

When possible, the Division will provide solutions and comments to the documents, prior to actual filing. The Securities and Exchange Commission has stated that it will, on a day-to-day basis, find solutions to problems non-United States issuers have with registering under the federal securities laws, including rule-making initiatives and meeting with non-United States issuers.[133]

The registration statement must be reviewed, cleared, and declared effective by the Securities and Exchange Commission before sales can be confirmed. It is unlawful to sell securities until the registration statement has been declared effective.[134] To facilitate crossborder offerings and listings, and recognising the particular difficulties of coordinating time schedules for cross-border offerings, the Securities and Exchange Commission staff review process has been tailored to accommodate the special scheduling demands for such offerings.

Generally, first comments are received within 30 days of submission. The Securities and Exchange Commission will respond formally to the registration statement with a 'comment letter', specifying any deficiencies that need to be addressed. The company, in turn, files a letter with the Securities and Exchange Commission responding to requests for information and describing proposed amendments to the prospectus.

Distribution. After the 'preliminary prospectus' (commonly referred to as a 'red herring' because of the red ink printed on the cover, stating that it is not a final prospectus and cannot be used to effect sales) has been filed with the Securities and Exchange Commission as part of the registration statement, it may be distributed for circulation among potential investors.

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133 Kosnick, 'The Role of the Securities and Exchange Commission in Evaluating Foreign Issuers Coming to United States Markets', 17 *Fordham Int'l LJ* S97, at pp S108–110 (1994).

134 15 United States Code, s 77e(1).

The underwriter will then assemble a syndicate, consisting of additional investment bankers who will place portions of the offering to achieve the desired distribution.

The lead underwriter will begin to accumulate indications of interest solicited through its efforts, as well as the syndicate's, from institutions and brokers that have approached their clients. This gives assurance that the offering is viable and helps to determine the final number of shares to be offered and the allocations to each investor.

The investment banker and the company will then design and perform the 'road show', a series of meetings with potential investors and analysts in various cities. The road show consists of a fairly elaborate formal presentation on the company's operations, financial condition, performance, markets, and products, delivered by the company's top executives, who are then available for questions.[135]

National Association of Securities Dealers Filing. Contemporaneously with filing with the Securities and Exchange Commission, the registration statement also is filed with the National Association of Securities Dealers, which reviews the underwriting compensation and offering terms. The National Association of Securities Dealers regulates the actions of broker-dealers, including underwriters, and must approve the compensation arrangements prior to the registration statement being declared effective.

While the Securities and Exchange Commission's review focuses on proper disclosure, the National Association of Securities Dealers review focuses on the fairness of underwriting compensation, terms, and arrangements. The National Association of Securities Dealers review is conducted by its Corporate Financing Department according to the National Association of Securities Dealers Corporate Financing Rules and Code of Procedure.[136]

Final Version of Prospectus. After first comments are received from the Securities and Exchange Commission, the issuer will respond to the Securities and Exchange Commission and, if required, amend the registration statement by providing amendments to the Securities and Exchange Commission.

Once the staff of the Securities and Exchange Commission believes that the registration conforms to the requirements of the applicable form, the Securities and Exchange Commission will declare the statement effective. The final version of the prospectus can now be printed, and delivered to prospective investors, and the registered securities may be sold.

Integration of Public and Private Offerings

In General. A fundamental issue in securities regulation is the idea of integration. The issue of integration is seminal in determining whether multiple securities transactions should be considered as part of the same offering.

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135 National Association of Securities Dealers Publications, *Going Public*, located at the NASDAQ web site, http://www.nasdaq.com.

136 National Association of Securities Dealers Publications, *Going Public*, located at the NASDAQ web site http://www.nasdaq.com.

The integration doctrine prevents an issuer from artificially aggregating multiple offerings into one transaction so as to avoid proper separate registration.

Abandoned Registered Offering. The integration issue is salient when an issuer has decided to switch between a public offering and a private offering when changing market or business conditions dictate such a switch. The manifestation of this problem is when an issuer files a registration statement for a public offering, which the Securities and Exchange Commission historically has deemed to be a general solicitation and subsequently decides to conduct a private offering.

Because the filing of the registration statement has historically been deemed as a general solicitation by the Securities and Exchange Commission that would be integrated into the proposed private offering, the private offering exemption would likely be unavailable to the issuer.[137]

Abandoned Private Offering. In the event that an issuer commences a private offering (but does not sell any securities in this private offering) prior to a registered offering, but then decides to file a registration statement, it is likely that these offerings could be integrated thereby causing a potential violation of section 5(c), which is more commonly known as 'gun jumping'.

To provide clarification on this issue, the Securities and Exchange Commission has adopted new rule 155[138] which provides a safe harbour, based on compliance with certain conditions, for a registered offering following an abandoned private offering or, conversely, a private offering following an abandoned (or failed) registered offering, without integrating the registered and private offerings in either case.[139]

Private Placements by Non-United States Issuers

Exemptions Available to Non-United States Issuers

Exemption from Registration

Section 5(a) of the 1933 Act provides that it is unlawful for a person or entity to use the mails or any means or instrumentality of interstate commerce to sell unregistered securities, whether the issuer is a United States or a non-United States person or entity.[140] However, there is a series of statutory provisions, rules, and interpretations that exempt certain transactions from section 5(a), a number of which are available to non-United States issuers offering and selling securities within the United States.[141]

These exemptions relate only to the specified transaction and not to any future sale or transfer. As a result, the resale of the securities must be reviewed on a transaction-by-transaction

137 Securities Release Number 33-7943 (26 January 2001).
138 17 Code of Federal Regulations, s 230.155.
139 Securities Release Number 33-7943 (26 January 2001).
140 Securities Act of 1933, 15 United States Code, s 77e (a).
141 Securities Act of 1933, 15 United States Code, s 77d.

basis and an exemption found for each resale or transfer. Securities sold in exempt transactions are generally deemed restricted securities, which may be resold only if registered or if another exemption is available.

Certain Exemptions Not Available to Non-United States Issuers

Certain exemptions available for domestic entities are not available for non-United States issuers offering and selling securities within the United States. The first of these is the intrastate exemption set forth in section 3(a)(11) of the 1933 Act. This exemption from registration is available to an issuer organised under the laws of a state or territory of the United States and doing business in that same state or territory.[142]

Similarly, Regulation A, promulgated under section 3(b) of the 1933 Act,[143] which provides for a conditional exemption from registration for public offerings not exceeding US $5 million, will not be available to most non-United States issuers because its use is limited to issuers organised under the laws of the United States or Canada.[144]

Exemptions Applicable to Non-United States Issuers

In General. The 1933 Act provides statutory authority for exemptions from the registration requirements under section 5. Section 3(a)(10) provides an exemption when securities are issued under a plan of exchange approved by a court or another governmental authority. Section 3(b) provides authority for the Securities and Exchange Commission to exempt transactions where registration is deemed not necessary because of the small amount contemplated by the offering, under US $5 million in value, or by the limited character of the offering.[145] Section 4(2) exempts transactions by an issuer not involving a public offering.[146] Section 4(6) exempts transactions with accredited investors.[147]

This patchwork of exemptions in the statute, and the rules and regulations promulgated by the Securities and Exchange Commission thereunder, form the basis for the exemption of certain limited offerings from the registration provisions of the 1933 Act.

Central to the notion of exempt transactions is the concept of integration. If an issuer could selectively sell securities under one or more exemptions in a concerted scheme to evade the registration requirements or in contravention of any particular exemption, the objectives of the regulatory framework would not be met. The Securities and Exchange Commission has identified certain factors to determine whether the various offerings should be integrated, including whether the offerings represent a single plan of financing, are the same class of securities, are made at or about the same time, involve the same

142 Securities Act of 1933, 15 United States Code, s 77c(a)(11).
143 Securities Act of 1933, 17 Code of Federal Regulations, ss 230.251–230.263, promulgated under 15 United States Code, s 77c(b).
144 17 Code of Federal Regulations, s 230.251(a)(1).
145 Securities Act of 1933, 15 United States Code, s 77c(b).
146 Securities Act of 1933, 15 United States Code, s 77d(2).
147 Securities Act of 1933, 15 United States Code, s 77d (6).

consideration, or are being made for the same general purpose. Each transaction and the history of the issuer needs to be reviewed to determine whether any or all of the offerings are integrated for United States securities law purposes.[148]

Regulation D Exemptions. In 1982, the Securities and Exchange Commission adopted Regulation D under the Securities Act to clarify certain statutory exemptions available for the sale of securities by issuers on a private basis.[149] Among other things, these rules clarify the disclosure obligations for certain types of limited offerings, and they set forth clear criteria for integration of previous offerings. There are three exemptions under Regulation D, rules 504, 505, and 506, all of which may be used by non-United States issuers, as follows.

Rule 504 Exemption. Rule 504 provides for an exemption from registration pursuant to section 3(b) of the 1933 Act.[150] This exemption from registration will apply to an offer of securities not exceeding US $1 million during any 12-month period. The exemption is available to any issuer, including a non-United States issuer, so long as it is not subject to the reporting requirements of sections 13 or 15(d) of the 1934 Act and is not an investment company.[151] However, rule 504 is not available for a 'blank check offering' by a development stage company. A blank check offering is an offering where no specific business plan or purpose exists or where a business plan exists to engage in a merger or acquisition with an unidentified company or companies.[152]

Since 1992, when it was last revised, the most attractive aspect of this exemption was the ability to conduct offerings to an unlimited number of investors without regard to their accreditation and the permitted use of general solicitation and advertising to market the offering.[153] However, due to excessive abuse of this exemption and its unique 'freely tradable' characteristics, effective 7 April 1999, the Securities and Exchange Commission revised rule 504 to protect against these abuses.

As such, rule 504 has been modified so that the only circumstances where general solicitation and the freely tradable securities are now permitted is when an offering has been registered under state law requiring public filing and delivery of a disclosure document to investors before sale, or if an offering has been exempted under state law permitting general solicitation and advertising so long as sales are made only to accredited investors.[154] In the event that an offering under rule 504 does not qualify under either one of the above listed exceptions, it may not be made by any general solicitation or advertisement and the securities purchased thereunder will be deemed 'restricted securities',[155] as discussed below.

148 17 Code of Federal Regulations, s 230.502(a).
149 17 Code of Federal Regulations, ss 230.500 *et seq*.
150 17 Code of Federal Regulations, s 230.504(a).
151 17 Code of Federal Regulations, ss 230.504(a)(1) and 230.504(a)(2).
152 17 Code of Federal Regulations, s 230.504(a)(3).
153 Hayes, 'Private Placements-Recent Developments and Current Issues', 1084 *PLI*, *30th Annual Institute on Securities Regulation* (1998) 501, at p 526.
154 Securities Act Release Number 7644 (26 February 1999).
155 17 Code of Federal Regulations, ss 230.502(c) and (d).

Notwithstanding the foregoing, the issuer should be aware that, whether or not disclosure requirements exist, the issuer is still subject to the antifraud provisions of the 1933 Act, which may cause the issuer to provide full and complete disclosure in any event.[156]

Rule 505 and Rule 506 Exemptions. Rules 505 and 506 are similar to rule 504, but they permit larger amounts to be offered, subject to stricter requirements. Rule 505 provides an exemption from registration pursuant to section 3(b) of the 1933 Act, and rule 506 provides an exemption under section 4(2) of the 1933 Act. Rule 505 allows an issuer to offer up to US $5 million during a 12-month period.[157] In contrast, rule 506 sets no limitation on the amount that may be offered.[158]

Another restriction is that the number of purchasers in a rule 505 or rule 506 offering is limited to 35 non-accredited investors.[159] For purposes of this numerical limit, a corporation, partnership, or other entity will be deemed to be one purchaser, so long as it was not organised for the purpose of purchasing the securities in question.[160]

In addition, a person and his relative, spouse, or spouse's relative will be deemed to be one investor if they have the same principal residence.[161] Nor does the numerical limit include persons qualifying as 'accredited investors'.[162] The term 'accredited investor' includes:

- Certain financial and investment institutions;
- The directors, officers, and general partners of the issuer; and
- Persons with a net worth, either individually or jointly with a spouse, of US $1 million or an individual income of US $200,000, or US $300,000 joint income with a spouse, during the two most recent years, if he expects to reach the same income level in the current year.[163]

It should be noted that, for purposes of rule 506, all non-accredited investors must possess sufficient knowledge and expertise in financial and business matters so that they are capable of evaluating the merits and risks of the prospective investment.[164] Rule 505 contains no such requirement.

Rule 505 and 506 offerings may be made by any issuer, including non-United States issuers, except, in the case of a rule 505 offering, investment companies and companies meeting certain disqualification, or 'bad boy', provisions for previous improper conduct.[165] Unlike rule 504, neither type of offering, however, may be made by any general solicitation or advertisement under any circumstances.

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156 17 Code of Federal Regulations, s 230.503(a).
157 17 Code of Federal Regulations, s 230.505(b)(2)(i).
158 17 Code of Federal Regulations, s 230.506.
159 17 Code of Federal Regulations, s 230.505(b)(2)(ii); 17 Code of Federal Regulations, s 230.506(b)(2)(i).
160 17 Code of Federal Regulations, s 230.501(e)(2).
161 17 Code of Federal Regulations, s 230.501(e)(1).
162 17 Code of Federal Regulations, s 230.501(e)(1)(iv).
163 17 Code of Federal Regulations, s 230.501(a).
164 17 Code of Federal Regulations, s 230.506(b)(2)(ii).

Unlike rule 504, rules 505 and 506 require that certain disclosure be given to offerees within a reasonable amount of time prior to the sale of the securities in question.[166] While such disclosure is only required to be given to non-accredited investors, it is advisable to give disclosure to all potential investors, even if accredited.[167] The disclosure document generally takes the form of a 'private placement memorandum' that includes information required in rule 502(b)(2). In the case of a reporting issuer, the disclosure requirements may be primarily fulfilled by delivering certain of its 1934 Act filings to the offerees.

As to non-reporting issuers, the non-financial information to be included in the private placement memorandum must be the same kind of information required in Part II of Form 1-A, if the issuer is eligible to use Regulation A, or that required in Part I of a registration statement filed under the 1933 Act on the form that the issuer would be entitled to use for such a statement.[168] As discussed above, most non-United States issuers are not eligible to use Regulation A, since it is available only to United States and Canadian issuers.

Thus, the non-financial information required will be that required in Part I of the registration statement form available to the non-United States issuer, such as Form F-1.[169] Similarly, the financial information that must be included in a private placement memorandum will be that required on the applicable registration statement except that, in general, only a balance sheet dated within 120 days of the start of the offering need be certified by an accountant.

Finally, in offering securities under rules 505 or 506, prior to a purchase, the issuer must give each purchaser a reasonable amount of time to ask questions and receive answers from the issuer's representatives and to obtain additional information. The additional information may be that which the issuer already possesses or which can be acquired without unreasonable effort or expense to verify the accuracy of the information provided.[170]

Although United States securities law provides that certain transactions are exempt from registration and, in certain circumstances, does not mandate specific disclosure requirements, these transactions are still subject to the antifraud provisions of the United States securities laws which provide for civil liability for misleading statements made, or material information omitted, in the offer and sale of securities.[171]

Section 4(6) Exemption. Another exemption from the registration requirements of section 5(a) is set forth in section 4(6) of the 1933 Act.[172]

This exemption from registration is similar to that set forth in rule 505 in that it is available for offers not exceeding US $5 million and requires the filing of Form D with the Securities and Exchange Commission. Section 4(6) contains no numerical limit on

165 17 Code of Federal Regulations, s 230.505(b)(2 (iii).
166 17 Code of Federal Regulations, s 230.502(b)(1).
167 17 Code of Federal Regulations, s 230.502(b)(1).
168 17 Code of Federal Regulations, s 230.502(b)(2)(i)(A).
169 17 Code of Federal Regulations, s 230.502(b)(2)(i)(C).
170 17 Code of Federal Regulations, s 230.502(b)(2)(v).
171 17 Code of Federal Regulations, s 240.10b-5.
172 Securities Act of 1933, 15 United States Code, s 77d(6).

offerees, but offers and sales may be made to accredited investors only. In addition, no general solicitation or advertisement may be made.

Filing Requirements. Although the Regulation D and section 4(6) exemptions permit an offer without meeting the registration requirements of section 5(a), issuers taking advantage of such exemptions from registration must still file a document, Form D, with the Securities and Exchange Commission although, for purposes of Regulation D, such filing is not a condition to the availability of an exemption.

Pursuant to rule 503, five copies of Form D, one of which must be manually executed, must be filed with the Securities and Exchange Commission within 15 days after the first sale of the securities in question.[173] However, once a Form D is filed, generally, there will be no further periodic filings required.

Section 3(a)(10). Another available limited exemption is found under section 3(a)(10) of the Securities Act. This exemption is available for offers and sales of securities in specific exchange transactions. To rely on this exemption, the following are required:

- The subject securities must be issued in exchange for securities, claims, or property (not cash); and
- The terms and conditions of the transaction must be adjudicated to be fair pursuant to an open, duly noticed, and authorised hearing before a governmental authority or court.[174]

The attractiveness of this option for non-United States issuers is that the Securities and Exchange Commission has interpreted the term 'court' to include courts from foreign jurisdictions that meet certain requirements.[175]

The section 3(a)(10) exemption is available without any action by the Securities and Exchange Commission.[176] If an issuer is unsure as to whether or not this exemption is available, they can request (before the fairness hearing) a 'no-action' position from the Securities and Exchange Commission. Issuers should note that securities issued pursuant to a section 3(a)(10) exemption are not 'covered securities' as contemplated by the National Securities Markets Improvement Act and, as such, they may be subject to various blue sky regulations.[177]

Restrictions on Transfer

Securities sold under rules 504, 505, or 506 or under section 4(6) are deemed to be restricted securities.[178] As such, the securities may be resold only if they are registered or an exemption applies.

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173 17 Code of Federal Regulations, s 230.503(a) and (b).
174 Securities Act of 1933, 15 United States Code, s 77c(a)(10).
175 Revised Staff Legal Bulletin Number 3 (CF) — Section 3(a)(10) (20 October 1999).
176 Revised Staff Legal Bulletin Number 3 (CF) — Section 3(a)(10) (20 October 1999).
177 Revised Staff Legal Bulletin Number 3 (CF) — Section 3(a)(10) (20 October 1999).
178 17 Code of Federal Regulations, s 230.502(d).

As restricted securities, such shares may not be resold unless they are registered or sold under an exemption from registration. The 'safe harbour' exemption set forth in rule 144 provides guidance as to when and how restricted securities can be resold in a transaction exempt from the registration requirements of the United States securities laws.[179] Rule 144 provides that, after restricted securities have been held by a purchaser for more than one year, they may be resold if certain requirements are met, namely:

- There must be available adequate current public information with respect to the issuer of the securities;[180]
- The purchaser may resell only an amount equal to a small percentage of the total outstanding securities of the same class — in general, one per cent — during a three-month period;[181]
- Such sales must be made in a brokers' transaction or through a market maker;[182] and
- If the amount of the securities to be resold by the purchaser during the three-month period exceeds 500 shares or has an aggregate purchase price in excess of US $10,000, the purchaser must file three copies of a notice on Form 144 with the Securities and Exchange Commission and, if the securities are admitted to trading on any national securities exchange, one copy must be filed with the exchange.[183]

However, if the purchaser desiring to resell the securities is not an affiliate of the issuer — generally, an officer, director, or 10 per cent shareholder — and has held the securities for more than two years, these restrictions will not apply.[184]

Rule 144A Restricted Securities

Rule 144A provides a non-exclusive safe harbour exemption from the registration requirements of the 1933 Act for certain resales of restricted securities to certain sophisticated institutional investors, referred to as 'qualified institutional buyers'. Rule 144A defines qualified institutional buyers as institutions that in the aggregate own and invest on a discretionary basis at least US $100 million in securities.[185]

Rule 144A imposes a 'reasonable belief' standard on sellers with respect to the status of buyers as qualified institutional buyers.[186] Rule 144A also imposes an information requirement where the issuer of the securities to be resold in reliance on rule 144A is neither a 1934 Act reporting company nor exempt from reporting requirements pursuant to rule 12g3-2(b). The required information includes:

- A brief statement of the nature of the business of the issuer and the products and services it offers; and

179 17 Code of Federal Regulations, s 230.144.
180 17 Code of Federal Regulations, s 230.144(c).
181 17 Code of Federal Regulations, s 230.144(e).
182 17 Code of Federal Regulations, s 230.144(f).
183 17 Code of Federal Regulations, s 230.144(h).
184 17 Code of Federal Regulations, s 230.144(k).
185 Securities Act Release Number 6862 (23 April 1990).
186 17 Code of Federal Regulations, s 230.144A.

- The issuer's most recent balance sheet and profit-and-loss and retained- earnings statements and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation.

The financial statements should be audited to the extent reasonably available. However, non-United States issuers who furnish the Securities and Exchange Commission with financial and business information already made public in their home countries pursuant to rule 12g3-2(b) need not comply with this requirement.

If a market for rule 144A securities develops, often the number of United States security holders will increase, subjecting many non-United States issuers to the registration and periodic reporting requirements of the 1934 Act. A rule 144A offering of American Depository Receipts or ordinary shares does not preclude an issuer from subsequently registering the securities with the Securities and Exchange Commission and applying for an exchange or NASDAQ listing. For example, the following non-United States issuers, after conducting rule 144A transactions, entered the United States public market for the first time:

- Telefonos de Mexico;
- Petro-Canada;
- Vitro;
- Micro Focus Group; and
- Enterprise Oil.[187]

Investment Outside the United States and Cross Border Transactions

In General

In 1990, the Securities and Exchange Commission adopted Regulation S to clarify the extraterritorial application of the registration provisions of United States securities laws.[188] Under Regulation S, any offer or sale of a security that is deemed to occur within the United States is subject to the registration provisions of United States securities laws, while any offer or sale of a security that is not deemed to occur within the United States is not subject to the registration provisions of United States securities laws.[189]

Regulation S is not an exemption from registration under United States securities laws; rather, it provides that offers and sales occurring outside of the United States are not subject to the registration requirements of United States securities laws. Regulation S speaks only to the registration provisions of United States securities law, and it does not limit or otherwise restrict application of the antifraud provisions of United States securities laws.[190]

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187 Jensen, 'The Attractions of the United States Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the United States Markets: From A Legal Perspective', 17 *Fordham Int LJ* (1994), ss 25 and 37.
188 Securities Act Release Number 6863 (24 April 1990).
189 17 Code of Federal Regulations, s 230.901.
190 17 Code of Federal Regulations, s 230.900, Preliminary Note 1.

In addition to setting forth the foregoing general principle regarding territorial application of the registration provisions of United States securities laws, Regulation S provides three categories of non-exclusive[191] 'safe harbours'[192] for specified securities transactions. Offers and sales of securities in transactions which meet all of the conditions of any one of the three categories of non-exclusive safe harbours are deemed to occur outside the United States and, therefore, are not subject to the registration requirements of United States securities laws.

The safe harbours may be utilised for initial issuances of securities by an issuer, a distributor, or any of their respective affiliates or persons acting on their behalf and may be utilised for resale transactions by such persons.[193] Regulation S also provides a non-exclusive safe harbour for resale transactions by persons other than an issuer, a distributor, any of their respective affiliates (except officers or directors who are affiliates solely by virtue of holding such position), or persons acting on their behalf.[194]

Equity securities of a United States 'domestic issuer' issued in a transaction which relies on Regulation S to avoid registration under United States securities laws are deemed 'restricted securities' under United States securities laws and may only be resold in a transaction which complies with the registration requirements of United States securities laws or an exemption therefrom, or in a transaction occurring outside the United States in accordance with Regulation S.[195]

Regulation S is not available for any transaction that, although in technical compliance with the provisions of Regulation S, is part of a plan or scheme to evade the registration provisions of United States securities laws.[196] In this regard, subsequent to the adoption of Regulation S in 1990, the Securities and Exchange Commission issued an interpretative release, which identified practices occurring in the context of Regulation S to be abuses.[197] Ultimately, in February 1998, the concerns of the Securities and Exchange Commission expressed in that interpretative release resulted in amendments to Regulation S designed to halt such abuses.[198]

General Principle

Regulation S provides that no offer or sale of a security which occurs outside of the United States will be subject to the registration requirements of United States securities laws.[199] The need for Regulation S stems from the broad extraterritorial reach of the registration provisions of United States securities laws. In the absence of Regulation S, or a

191 Code of Federal Regulations, s 230.900, Preliminary Note 5.
192 17 Code of Federal Regulations, s 230.903(b)(1)–(b)(3).
193 17 Code of Federal Regulations, s 230.903(a).
194 17 Code of Federal Regulations, s 230.904.
195 Code of Federal Regulations, s 230.905.
196 17 Code of Federal Regulations, s 230.900, Preliminary Note 2.
197 Securities Act Release Number 7190 (27 June 1995).
198 Securities Act Release Number 7505 (17 February 1998).
199 17 Code of Federal Regulations, s 230.901.

comparable administrative interpretation of the provisions of United States securities laws, which require the registration of securities,[200] such provisions literally apply to any offer or sale of a security involving any communication between the United States and any other country.[201]

Regulation S provides safe harbours for specified issuance and resale transactions so that these transactions will be deemed to occur outside the US. These safe harbours are non-exclusive. As a result, transactions not in compliance with a safe harbour may still be deemed to occur outside the United States for purposes of United States securities laws and rule 901.

Due to the lack of guidance on the issue of when offers or sales of a security are deemed to occur outside of the United States in instances where a safe harbour provided by Regulation S is not utilised, rule 901 may be helpful in instances where non-United States issuers may inadvertently or unknowingly trigger the jurisdictional reach of United States securities laws in a transaction that arguably has not occurred in the United States. Otherwise, a Regulation S safe harbour is effectively the only way to ensure availability of the jurisdictional exclusion from application of the registration requirements of United States securities laws.

Safe Harbours for Transactions by Issuers, Distributors, or Affiliates

In General

In General. Regulation S provides three categories of safe harbours for use in transactions by an issuer, a distributor, or any of their respective affiliates or persons acting on their behalf. These safe harbours may be used for transactions in which securities are issued and subsequently resold by such persons.

All three safe harbours require compliance with two general conditions, ie, an offshore transaction with no directed selling efforts, as well as the more specific conditions for each category.

General Conditions. Regulation S requires that the offer or sale be made in an 'offshore transaction'. For purposes of the three safe harbour categories of Regulation S, an offer or sale of securities is made in an offshore transaction if:

- The offer is not made to a person in the United States; and
- Either the buyer is outside the United States at the time the buy order is originated, or the seller and any persons acting on its behalf reasonably believe the buyer is outside the United States or the transaction is executed on an established non-United States securities exchange located outside the United States.[202]

Offers and sales which are specifically targeted at identifiable groups of United States citizens residing abroad, such as United States military personnel, are not deemed to be

200 Securities Act of 1933, 15 United States Code, s 77e.
201 Securities Act of 1933, 15 United States Code, s 77b(7).
202 17 Code of Federal Regulations, s 230.902(h)(1).

made in an offshore transaction.[203] However, offers and sales to certain international organisations, such as the International Monetary Fund and the United Nations, and their affiliates are excluded from the definition of United States persons and will be deemed to be made in an offshore transaction.[204]

In addition, offers and sales to persons holding discretionary or similar accounts (other than an estate or trust) held for the benefit of a non-United States person by a dealer or other professional fiduciary organised, incorporated, or resident in the United States also are deemed to be made in an offshore transaction.[205]

Regulation S requires that no 'directed selling efforts' be made in the United States by the issuer, distributor, or any of their respective affiliates or persons acting on their behalf with respect to the offer or sale.[206] 'Directed selling efforts' is defined as any activity undertaken for the purpose, or which can reasonably be expected to have the effect, of conditioning the United States market for such securities.[207]

Directed selling efforts include advertisements placed in a publication with a general circulation in the United States,[208] but they do not include:

- Advertisements required to be published by law, provided the advertisement contains no more information than legally required and contains a statement regarding the restricted nature of such securities pursuant to United States securities laws;
- Contact with persons excluded from the definition of a United States person;[209]
- A tombstone advertisement in a publication with a general circulation in the United States, provided such publication has less than 20 per cent of its circulation in the United States, such advertisement contains a statement regarding the restricted nature of such securities pursuant to United States securities laws, and such advertisement contains only certain limited information about the offering;[210]
- *Bona fide* visits by prospective investors to the issuer's United States facilities;

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203 17 Code of Federal Regulations, s 230.902 (h)(2).

204 17 Code of Federal Regulations, s 230.902(h)(3); 17 Code of Federal Regulations, s 230.902(k)(2)(vi).

205 17 Code of Federal Regulations, s 230.902(h)(3); 17 Code of Federal Regulations, s 230.902(k)(2)(i).

206 17 Code of Federal Regulations, s 230.903(a)(2).

207 17 Code of Federal Regulations, s 230.902(c)(1).

208 17 Code of Federal Regulations, s 230.902(c)(2).

209 17 Code of Federal Regulations, s 230.902(c)(3). For purposes of Regulation S, a United States person is defined as: (a) any natural person resident in the United States; (b) any partnership or corporation organised or incorporated under the laws of the United States; (c) any estate of which any executor or administrator is a United States person; (d) any trust of which any trustee is a United States person; (e) any agency or branch of a non-United States entity located in the United States; (f) any non-discretionary or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit of a United States person; (g) any discretionary or similar account (other than an estate or trust) held by a dealer or other fiduciary organised, incorporated, or resident (if an individual) in the United States; and (h) any partnership or corporation organised or incorporated under laws of any jurisdiction other than the United States and formed by a United States person to invest in securities not registered under United States securities law, unless organised and owned by accredited investors who are not natural persons, estates, or trusts; 17 Code of Federal Regulations, s 230.902(o)(1).

210 17 Code of Federal Regulations, s 230.902(c)(3)(iii)(C).

- Distribution in the United States of a non-United States broker-dealer's price quotations by a third-party system that distributes such quotes primarily outside the United States, provided transactions cannot be executed through such system with persons in the United States and no impermissible contacts may be initiated with 'United States persons' or persons in the United States;[211]
- Publication by the issuer of a notice containing only certain limited information;[212] and
- Providing journalists with access to press conferences held outside the United States, meetings with the issuer or selling shareholder representatives held outside the United States, or written press-related materials released outside the United States, at or in which a present or proposed offering is discussed, if certain other requirements also are satisfied.[213]

Specific Conditions

Category 1. The Category 1 safe harbour[214] is available for transactions in the following securities, without having to meet any conditions, other than the offer and sale being made in an offshore transaction and no directed selling efforts are made in the United States by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing:

- Securities issued by an issuer that is not a domestic issuer[215] which reasonably believes at commencement of the offering that there is no 'substantial United States market interest'[216] in the class or type of securities offered or sold [or issuable on exercise or conversion of the class or type of securities offered or sold], and securities of an issuer that is not a domestic issuer which are offered and sold in an offering that is directed into a single country other than the United States to the residents thereof in accordance with the laws and customary practices of such country;

211 17 Code of Federal Regulations, s 230.902(c)(3)(v)(B).
212 17 Code of Federal Regulations, s 230.902 (c)(3)(vi).
213 17 Code of Federal Regulations, s 230.902(c)(3)(vii).
214 17 Code of Federal Regulations, s 230.903(b)(1).
215 For purposes of Regulation S, a United States 'domestic issuer' is defined as any issuer other than a non-United States government or non-United States issuer, except a non-United States issuer meeting the following conditions: (a) more than 50 per cent of its outstanding voting securities are held of record directly or indirectly by United States residents; and (b) the majority of its directors or executive officers are United States citizens or residents, more than 50 per cent of its assets are located in the United States, or its business is administered principally in the United States. 17 Code of Federal Regulations, s 230.902(e).
216 For purposes of Regulation S, 'substantial United States market interest' exists with respect to a class of equity securities if: (a) securities exchanges and quotation systems in the United States, in the aggregate, constituted the single largest market for such securities for the prior fiscal year or period since the issuer's inception (if there is no prior fiscal year); or (b) 20 per cent or more of all trading in such securities took place in, on, or through securities exchanges and quotations systems in the United States and less than 55 per cent of all trading in such securities took place in, on, or through securities markets of a single country other than the United States (17 Code of Federal Regulations s 230.902(j)(1)). For purposes of Regulation S, 'substantial United States market interest' exists with respect to an issuer's debt securities, other than certain exempt securities (17 Code of Federal Regulations, s 230.902(j)(3)) if: (a) its debt securities are held of record by 300 or more 'United States persons'; (b) US $1 billion or more of its debt securities are held of record by 'United States persons'; and (c) 20 per cent or more of its debt securities are held of record by 'United States persons'. 17 Code of Federal Regulations, s 230.902(j)(2).

- Non-convertible debt securities of a domestic issuer which are offered and sold in an offering that is directed into a single country other than the United States to the residents thereof in accordance with the laws and customary practices of such country, provided that such securities are non-United States dollar-denominated and are not convertible into United States dollar-denominated or linked to United States dollars (other than through ordinary commercial currency or interest-rate swap transactions) in a manner that in effect makes them United States dollar-denominated securities;
- Securities which are backed by the full faith and credit of a government other than the United States; and
- Securities which are offered and sold to employees of the issuer or its affiliates pursuant to an employee benefit plan established and administered in accordance with the laws and customary practices of a country other than the United States, provided such securities are issued as compensation for bona fide services rendered in connection with the business of such issuer or its affiliates and not in connection with the offer and sale of securities, interests in the plan are not transferable other than on the death of the holder thereof, the issuer takes steps to preclude the offer and sale of interests in the plan or securities under the plan to United States residents other than employees on temporary assignment in the United States, and the plan documentation contains a statement regarding the restricted nature of such securities pursuant to United States securities laws.

Category 2. The Category 2 safe harbour[217] is available for transactions in securities not eligible for the Category 1 safe harbour and that are equity securities of a 'reporting issuer'[218] that is not a United States domestic issuer, debt securities of a reporting issuer, or debt securities of a non-reporting issuer that is not a United States domestic issuer, provided they comply with all of the following conditions in addition to the two general conditions of rule 903(a)(1) and (a)(2), namely:

- 'Offering restrictions'[219] are implemented;

217 17 Code of Federal Regulations, s 230.903(b)(2).

218 For purposes of Regulation S, a 'reporting issuer' is defined as an issuer, other than an investment company, that: (a) has a class of securities registered under United States securities laws or that is required to file periodic reports with the United States Securities and Exchange Commission; and (b) has filed all reports and other material required to be filed with the Securities and Exchange Commission for a period of at least 12 months (or such shorter period that the issuer was subject to such filing requirement) immediately preceding the offer or sale of securities made in reliance on Regulation S 17 Code of Federal Regulations, s 230.902(i).

219 For purposes of Regulation S, offering restrictions are implemented if: (a) each distributor agrees in writing that all offers and sales during the applicable distribution compliance period will be made only in accordance with Regulation S, the registration requirements of United States securities laws, or an exemption therefrom and, with respect to offers and sales of equity securities of United States domestic issuers, not to engage in hedging transactions during the applicable 'distribution compliance period' except in compliance with United States securities laws; (b) all offering materials and documents (other than press releases) used during the applicable distribution compliance period include a statement regarding the restricted nature of such securities pursuant to United States securities laws and, with respect to offers and sales of equity securities of domestic issuers, include a statement that hedging transactions may not be conducted except in compliance with United States securities laws and such statements appear on the cover or inside cover of the prospectus or offering circular, in the underwritings of the prospectus or offering circular, and in any advertisements. 17 Code of Federal Regulations, s 230.902(g).

- The offer or sale, if made during a 40-day distribution compliance period,[220] is such that (a) each warrant bears a legend regarding the restricted nature of the warrant and securities issuable on exercise pursuant to United States securities laws and disclosing that the warrant may not be exercised by or on behalf of a United States person except in compliance with the registration requirements of United States securities laws or pursuant to an exemption therefrom, (b) each person exercising a warrant provides written certification that it is not a United States person and that the warrant is not being exercised on behalf of a United States person or provides a written opinion of legal counsel that the warrant and securities issuable on exercise are in compliance with the registration requirements of United States securities laws or exempt therefrom, and (c) procedures have been implemented to ensure that the warrants may not be exercised within the United States and that the securities issuable on exercise may not be delivered within the United States, other than in a transaction which qualifies as an offshore transaction unless, in compliance with the registration requirements of United States securities laws or pursuant to an exemption therefrom,[221] it is not made to a United States person or for the account or benefit of a United States person (other than a distributor); and
- Each distributor selling securities during a 40-day distribution compliance period to a distributor, dealer, or person receiving compensation in respect of the securities sold sends a notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales applicable to a 'distributor'.[222]

Category 3. The Category 3 safe harbour[223] is available for transactions in securities not eligible for the Category 1 or Category 2 safe harbours, provided that the offer and sale are being made in an offshore transaction and that no directed selling efforts are made in the United States by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing, and they comply with all of the following conditions:

- Offering restrictions are implemented;

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220 For purposes of Regulation S, the distribution compliance period is the period that begins the later of the date the securities were first offered to persons other than distributors or the date of closing of the offering and continues until the end of the relevant time period, except that: (a) all offers and sales by a distributor of an unsold allotment are deemed made during the distribution compliance period; (b) in a continuous offering, the distribution compliance period commences on completion of the distribution, as determined and certified by the managing underwriter; (c) in a continuous offering of identifiable tranches of non-convertible debt securities, the distribution compliance period for securities in a tranche commences on completion of the distribution of such tranche, as determined and certified by the managing underwriter; and (d) in a continuous offering of securities to be acquired on the exercise of warrants, the distribution compliance period commences on completion of the distribution of the warrants, as determined and certified by the managing underwriter if the requirements are satisfied. 17 Code of Federal Regulations, s 230.903(b)(5).

221 17 Code of Federal Regulations, s 230.902(f).

222 For purposes of Regulation S, a distributor is defined as any underwriter, dealer, or other person who participates, pursuant to a contractual arrangement, in the distribution of the securities offered or sold. 17 Code of Federal Regulations, s 230.902(d).

223 17 Code of Federal Regulations, s 230.903(b)(3).

- In the case of debt securities, the offer or sale, if made during a 40-day distribution compliance period, is not made to a United States person or for the account or benefit of a United States person (other than a distributor) and the securities are represented during the 40-day distribution compliance period by a temporary global security and, for persons other than distributors, until certification of beneficial ownership of the securities by a non-United States person or a United States person who acquired such securities in a transaction not requiring registration under United States securities laws;
- In the case of equity securities, the offer or sale, if made during a one-year distribution compliance period, is not made to a United States person or for the account or benefit of a United States person (other than a distributor), and the offer or sale, if made during a one-year distribution compliance period, is made in compliance with the following conditions: (a) the purchaser (other than a distributor) certifies that it is not a United States person and is not acquiring the securities for the account or benefit of a United States person or that it is a United States person who acquired the securities in a transaction not requiring registration under United States securities laws, (b) the purchaser agrees to resell the securities only in accordance with Regulation S, the registration requirements of United States securities laws, or an exemption therefrom and not to engage in hedging transactions except in compliance with United States securities laws, (c) securities of a domestic issuer are legended to the effect that transfer is prohibited except in accordance with Regulation S, the registration requirements of United States securities laws, or an exemption therefrom and that hedging transactions may not be conducted except in compliance with United States securities laws, and (d) the issuer is required, by contract or a provision in its governing documents, to refuse to register transfers of the securities not made in accordance with Regulation S, the registration requirements of United States securities laws, or an exemption therefrom or, if the securities are in bearer form or non-United States law prevents the issuer from refusing to register securities transfers, other reasonable procedures are implemented to prevent any transfer of the securities not made in accordance with Regulation S; and
- Each distributor selling securities, in the case of debt securities, during a 40-day distribution compliance period or, in the case of equity securities, during a one-year distribution compliance period, to a distributor, dealer, or person receiving compensation in respect of the securities sold sends a notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales applicable to a distributor.

Safe Harbour for Resale Transactions by Persons Other than Issuers, Distributors, or Affiliates

Regulation S also provides a safe harbour for resale transactions by persons other than an issuer, a distributor, any of their respective affiliates (except officers or directors who are affiliates solely by virtue of holding such position), or persons acting on their behalf.[224] Rule 904 requires that the offer or sale be made in an offshore transaction, that

224 17 Code of Federal Regulations, s 230.904.

no directed selling efforts be made in the United States by the seller, its affiliates, or any persons acting on their behalf with respect to the offer or sale, and that the transaction comply with all of the following conditions:

- In the case of an offer or sale during the applicable distribution compliance period by a dealer or person receiving compensation in respect of the securities sold, neither the seller nor any person acting on the seller's behalf knows that the offeree or buyer is a United States person and, if the seller or any person acting on the seller's behalf knows that the purchaser is a dealer or person receiving compensation in respect of the securities sold, the seller or person acting on the seller's behalf sends a notice to the purchaser stating that offers and sales of the securities during the distribution compliance period may be made only in accordance with Regulation S, the registration requirements of United States securities laws, or an exemption therefrom; and
- In the case of an offer or sale by an officer or director of the issuer of the securities who is an affiliate solely by virtue of holding such position, no compensation is paid in respect of the securities sold other than a usual and customary brokerage commission.[225]

Restrictions on Resale

Equity securities of a United States issuer acquired from the issuer, a distributor, or any of their respective affiliates in a transaction which is not subject to the registration requirements of United States securities laws by virtue of the general principle of rule 901 or the safe harbours of rule 903 are deemed restricted securities,[226] as defined in rule 144.[227]

Such restricted securities may only be resold in accordance with Regulation S, the registration requirements of United States securities laws, or an exemption therefrom.[228] Rule 144 provides clear guidance regarding when and how restricted securities may be resold in the United States in a transaction exempt from the registration requirements of United States securities laws.

Subject to the satisfaction of certain current public information, volume limitation, manner of sale, and notice conditions set forth in rule 144, restricted securities may generally be resold in the United States after a one-year holding period. Restricted securities held by non-affiliates of the issuer may generally be freely resold in the United States after a two-year holding period.[229]

Any restricted securities, as defined in rule 144, that are equity securities of a domestic issuer will continue to be deemed restricted securities after any resale transaction pursuant to the general principle of rule 901 or the safe harbour of rule 904 and, therefore, any applicable legend on such securities may not be removed on such a resale.

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225 17 Code of Federal Regulations, s 230.904.
226 17 Code of Federal Regulations, s 230.905.
227 17 Code of Federal Regulations, s 230.144.
228 17 Code of Federal Regulations, s 230.905.
229 17 Code of Federal Regulations, s 230.144(k).

Crossborder Transactions

In General

One ramification of the extraterritorial application of the registration provisions of the United States securities laws is the negative impact on United States investors in foreign private issuers. Previously, due to the registration provisions, United States shareholders in foreign private issuers would often be excluded from tender and exchange offers, business combinations, and rights offerings so as to avoid the reach of the registration mandates of the United States securities laws.

In an effort to remove this prejudice against United States shareholders, the Securities and Exchange Commission has recently adopted and/or modified rules 800, 801, and 802 to the Securities Act to address these concerns.[230]

Exemptive Rule 801

Under exemptive rule 801 of the Securities Act, equity securities issued in rights offerings by foreign private issuers will be exempt from the registration requirements of the Securities Act if United States securities holders own 10 per cent or less of the issuer's securities that are subject of the rights offering.

Exemptive Rule 802

Under exemptive rule 802 of the Securities Act, equity securities issued in exchange offers for foreign private issuers' securities and securities issued in business combinations involving foreign private issuers rights offerings by foreign private issuers will be exempt from the registration requirements of the Securities Act and the qualification requirements of the Trust Indenture Act, if United States securities holders own 10 per cent or less of the subject class of securities.

Exemption from Rule 14e-5

Tender offers for the securities of foreign private issuers will be exempt from new rule 14e-5 (formerly 10b-13) of the Exchange Act, which prohibits a bidder from purchasing securities other than that pursuant to the tender offer. This exemption will permit purchases outside the tender offer during the offer when United States security holders hold 10 per cent or less of the subject securities.

For those instances where an exchange offer for securities of a foreign private issuer constitutes a tender offer under United States securities laws, thereby invoking certain registration

230 Securities Act Release Number 7759; Exchange Act Release Number 42054; Trust Indenture Act Release Number 2378; and International Series Release Number 1208 (22 October 1999).

requirements under the Williams Act, the Securities and Exchange Commission has enacted the following companion rules to rule 14D that mimic the modified rules 801 and 802.[231]

Again, it must be noted that the foregoing exemptions do not obviate the application of the United States antifraud and antimanipulation rules or any applicable state securities laws.

Trading of Non-United States Securities

In General

In order for a non-United States issuer to list its securities on a United States exchange or over-the-counter market, it must either register under section 12(b) of the 1934 Act to list on an exchange or under section 12(g) of the 1934 Act to list on the over-the-counter market.[232] Listing is accomplished either contemporaneously with the initial public offering of the non-United States issuer's securities in the United States, or directly without a corresponding financing.

It is unlawful for anyone to execute a trade in a security, other than an exempted security, on a national securities exchange unless the security is registered with the Securities and Exchange Commission pursuant to section 12(b) of the 1934 Act.[233]

Prior to 1964, registration under the 1934 Act was limited to securities of companies listed on a national securities exchange. Because registration under the 1934 Act activated the continuous reporting requirements, many companies purposefully

231 The Securities and Exchange Commission has created a Tier I Exemption and a Tier II Exemption. As to a Tier I Exemption, the recently adopted rules provide that tender offers for the securities of a foreign private issuer will be exempt from most provisions of the Exchange Act and rules governing tender offers when United States security holders hold 10 per cent or less of the subject securities, based on the 'look through' analysis described contained in rule 12(g)3-2(a). In addition to bidders, the subject company, or any officer, director, or other person who otherwise would have an obligation to file Schedule 14D-9 also may rely on the exemption. However, it must be noted that the Tier I Exemption is not available if the target company is an investment company registered or required to be registered under the Investment Company Act of 1940. Rule 14d-1(c)(4), 17 Code of Federal Regulations, s 240.14d(c)(4). As to a Tier II Exemption, when United States security holders hold 40 per cent or less of the class of securities of the foreign private issuer sought in the offer, limited tender offer exemptive relief will be available to bidders to eliminate frequent areas of conflict between United States and foreign regulatory requirements. This codification of current exemptive and interpretive positions is now referred to as a Tier II Exemption. However, it must be noted that the Tier II Exemption is not available if the target company is an investment company registered or required to be registered under the Investment Company Act of 1940 unless it is a closed end investment company. In addition, the target company must be a foreign private issuer. Rule 14d-1(d)(1)(i), 17 Code of Federal Regulations, s 240.14d(d)(1)(i). Securities Act Release Number 7759; Exchange Act Release Number 42054; Trust Indenture Act Release Number 2378; and International Series Release Number 1208 (22 October 1999).

232 Securities and Exchange Act of 1934, 15 United States Code, section 78l(b) and (g).

233 Securities and Exchange Act of 1934, 15 United States Code, s 78l(a).

avoided listing on a national exchange to side-step such regulation. As a result, Congress amended section 12(g)(1) to provide that:

> Every issuer who is engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce shall . . .
>
> (b) within 120 days after the last day of its first fiscal year . . . on which the issuer must have assets exceeding US $10 million and a class of equity security (other than an exempted security) held of record by 500 or more persons.
>
> . . . register such security by filing with the Securities and Exchange Commission a registration statement . . . with respect to such security containing such information and documents as the Securities and Exchange Commission may specify comparable to that which is required in an application to register a security pursuant to sub-section (b) of this section. Each such registration statement will become effective sixty days after filing with the Securities and Exchange Commission or within such shorter period as the Securities and Exchange Commission may direct. Any issuer may register any class of equity security not required to be registered by filing a registration statement pursuant to the provisions of this paragraph.[234]

The Securities and Exchange Commission has exempted from registration under section 12(g) companies that would otherwise be subject to registration if total assets do not exceed US $10 million.[235] The asset test and the number- of-shareholders test is applied collectively, ie, the issuer must have both total assets of US $10 million or greater and 500 or more shareholders together before it is required to register under the 1934 Act.

Exchange Act Registration

To register the securities of a non-United States company on an exchange or market, the company must either use a simplified registration procedure available on Form 8-A for registrants who have conducted a United States public offering of the class of securities, or file on Form 20-F, which is a more comprehensive disclosure document, for issuers that have not conducted a public offering and rather intend to directly list their securities. Either form of registration enables the company to list on either a stock exchange or market and satisfies the requirements of either section 12(b) or section 12(g) of the 1934 Act.

Form 8-A may be used for a class of securities to be effective on filing with Form 8-A, for non-United States issuers that already have a class of securities registered under the 1934 Act, or to be effective simultaneously with the effectiveness of a concurrent registration statement which is filed pursuant to the 1933 Act.[236] Form 8-A is often used to register

234 Securities and Exchange Act of 1934, 15 United States Code, s 78l(g)(1).

235 17 Code of Federal Regulations, s 240.12g-1, as amended in Exchange Act Release Number 37,157 (9 May 1996); [1996–1997 Transfer Binder] Federal Securities Law Rep, paragraphs 85,801 and 88,001.

236 Form 8-A, General Instruction A(c).

classes of securities on an exchange on which other securities of the registrant are registered, such as common shares, preferred shares, or debt instruments. The information required in Form 8-A is:

- A description of the securities to be registered, pursuant to item 202 of Regulation S-K;[237]
- A list of the exhibits to be incorporated by reference or filed as part of the registration statement; and
- The signature of the registrant. Documents filed as part of the concurrent public offering or in prior 1934 Act filings are incorporated by reference.

Form 20-F

In addition to filing a registration statement under the 1933 Act for any public offering of securities, a foreign private issuer must file to register its securities under the 1934 Act. To assist foreign private issuers with the complexities of 1934 Act registration and periodic reports, the Securities and Exchange Commission has created a 'foreign integrated disclosure system', which attempts to balance investor protection with facilitating the free flow of capital among nations.

The foreign integrated disclosure system is limited to issuers who file Form 20-F on an annual basis and are non-Canadian foreign private issuers registering their securities under section 12 of the 1934 Act.[238] There is a different standard for Canadian issuers as the Securities and Exchange Commission has previously distinguished the North American foreign private issuer — those from Canada and Mexico — from other foreign private issuers.[239]

A foreign private issuer is required to register its equity securities under section 12(g) of the 1934 Act if:

- The securities are listed, or are going to be listed, on a United States stock exchange or market; or
- The issuer has more than US $10 million of total assets and more than 500 stockholders of whom more than 300 are United States residents.[240]

In addition, a non-United States issuer that wishes to become listed on a United States exchange is required to register under section 12(b) of the 1934 Act[241] and the non-United States issuer that wishes to become listed on the NASDAQ is required to register under section 12 (g) of the 1934 Act.[242]

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237 17 Code of Federal Regulations, s 229.202.
238 17 Code of Federal Regulations, s 249.220f.
239 Securities Act Release Number 6437 (19 November 1982).
240 17 Code of Federal Regulations, s 240.12g-1, as amended in Release Number 34-37157 (1 May 1996).
241 15 United States Code, s 78l(b).
242 Securities and Exchange Act of 1934, 15 United States Code, s 78l(g).

The Securities and Exchange Commission adopted the foreign integrated disclosure system for offerings of securities issued by foreign private issuers, based on the theory that a foreign private issuer already furnishing information on a continuous basis under the 1934 Act reporting requirements should be able to use that information when it makes a public offering in the United States.[243] The foreign integrated disclosure system is based on those disclosures required by Form 20-F.[244]

Rather than the two separate documents of Form 10-K and the Annual Report to Shareholders used for United States issuers, the single Form 20-F may be used as the primary 1934 Act registration and annual report form for foreign private issuers. On the cover page of Form 20-F, the issuer notes whether the Form 20-F is being used as an annual report pursuant to section 13 or section 15(d), or in connection with registration pursuant to section 12(b) or section 12(g) of the 1934 Act.

Form 20-F requires the registrant to provide similar information as required by Form F-1. However, Form 20-F calls for specific disclosure concerning:

- A description of property;
- Pending legal proceedings;
- Control of the registrant;
- Nature of the trading market(s) for the securities;
- Exchange controls and other limitations that would affect payments of dividends or interest, or exercise of voting rights;
- Taxation;
- Selected financial data for the last five years;
- Management's discussion and analysis of financial condition and results of operations;
- Derivatives disclosure;
- Directors and officers, and their remuneration as a group;
- Options to purchase securities;
- Material transactions between the issuer and its management;
- If used as a registration form, the securities being registered;
- If used as an annual report form, defaults on senior securities and changes in securities and in security for registered securities;
- A description of business; and
- Audited financial statements under United States GAAP or reconciled with United States GAAP.[245]

When it was initially adopted in 1979, the Securities and Exchange Commission stated that Form 20-F represented a 'significant improvement in the amount of information required of foreign issuers in the United States, placing their required disclosures on a

243 Exchange Act Release Number 16,371 (29 November 1979).
244 17 Code of Federal Regulations, s 249.220f.
245 17 Code of Federal Regulations, s 249.220f.

level closer to that required of domestic issuers'.[246] At the same time, in recognition of the 'differences in various national laws and businesses and accounting customs [to be taken] into account when assessing disclosure requirements for foreign issuers', the Securities and Exchange Commission indicated that substantial reductions in the proposed disclosure requirements had been made.[247]

Two major differences between the disclosure system for non-United States and domestic issuers are the disclosures of conflicts of interest and use of proceeds. Currently, items 11–13 of Form 20-F permit non-United States issuers to disclose options to purchase securities in the aggregate, as opposed to requiring disclosure for each individual. Additionally, currently, under Form 20-F, controlling persons need only disclose data concerning material transactions with control persons if such transactions have been made public in reports to shareholders. These requirements significantly compromise the more demanding conflict of interest requirements found in the domestic issuer's Regulation S-K.

Effective as of 30 September 2000, the revised Form 20-F generally incorporates the International Organisation of Securities Commissions standards. These modifications have been undertaken with the expressed intention of creating and promulgating a harmonised international disclosure standard.

However, the revised Form 20-F, specifically items 6 and 7, significantly change these differences. The new item 6 of Form 20-F eliminates the ability to disclose ownership interest of individual directors and management on an aggregate basis. However, if:

> . . . an individual member of management beneficially owns less than one per cent of the outstanding securities that fact may be stated instead of providing the specific number of shares that individual beneficially owns . . . .[248]

One additional significant change is that, under item 7 of the revised Form 20-F, the disclosure threshold for beneficial ownership has been reduced from 10 per cent to five per cent.[249]

Annual Reports

The primary objective of the Exchange Act is to assure the public availability of adequate material information about companies with publicly traded stock. On becoming a reporting company, a non-United States issuer becomes subject to regular reporting requirements under the foreign integrated disclosure system. As discussed above, non-United States companies become reporting companies as a result of registration of a class of securities under the 1934 Act[250] or registration of an offering of securities pursuant to the 1933 Act.[251]

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246 Exchange Act Release Number 16,371 (29 November 1979); 44 Fed Reg 70,132 (1979).
247 Exchange Act Release Number 16,371 (29 November 1979); 44 Fed Reg 70,132 (1979).
248 Securities Act Release Number 7745, Exchange Act Release Number 41936, International Series Release Number 1205 (28 September 1999).
249 Securities Act Release Number 7745, Exchange Act Release Number 41936, International Series Release Number 1205 (28 September 1999).
250 Securities and Exchange Act of 1934, 15 United States Code, s 78m.
251 Securities and Exchange Act of 1934, 15 United States Code, s 78o.

Form 20-F also is the form used by foreign private issuers to file their Annual Report pursuant to section 13 or section 15(d) of the 1934 Act. The annual report on Form 20-F needs to be filed within six months after the end of the fiscal year covered by such report, compared to Form 10-K for domestic issuers, which must be filed within 90 days of the end of the fiscal year.[252]

Interim Reports

Unlike a domestic issuer, foreign private issuers are not required to file quarterly reports on Form 10-Q or current reports on Form 8-K. Instead, the foreign private issuer is required to file with the Securities and Exchange Commission those interim reports that are required to be made public in the issuer's domicile, filed with a stock exchange on which the company's securities are traded, or otherwise distributed to stockholders.[253]

Form 6-K, the interim reporting form used by non-United States issuers, requires non-United States issuers to provide the information with English translations or English versions.[254] Financial statements contained in interim reports on Form 6-K are not required to be prepared under United States GAAP or reconciled to United States GAAP.[255]

Finally, the New York Stock Exchange, the American Stock Exchange, and NASDAQ require their listed non-United States companies to provide interim reports on at least a semi-annual basis. As a practical matter, many non-United States companies file quarterly reports on Form 10-Q so that current information is available to investors and to permit analysts to track the development of the company on a current basis. Many companies believe that these steps aid in the acceptance of the company in the marketplace and assist the company in managing shareholder relationships.

Proxy Requirements

Securities registered by a foreign private issuer eligible to use Form 20-F are exempt from the proxy requirements of the 1934 Act.[256]

For non-United States issuers who are not foreign private issuers, section 14 of the 1934 Act makes it unlawful for a company registered under section 12 of the 1934 Act to solicit proxies from its shareholders 'in contravention of such rules and regulations as the Securities and Exchange Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors'.[257]

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252 Form 20-F, General Instruction A(c).
253 17 Code of Federal Regulations, ss 240.13a-1–240.13a-17.
254 17 Code of Federal Regulations, s 240.13a-3, as modified by Exchange Act Release Number 16,371 (29 November 1979).
255 17 Code of Federal Regulations, s 240.15d-16 and s 240.13a-16.
256 17 Code of Federal Regulations, s 240.3a12-3(b).
257 Securities and Exchange Act of 1934, 15 United States Code, s 78n.

In general, prior to every meeting of its security holders, a company registered under the 1934 Act must furnish each shareholder with a proxy statement containing the information specified in Schedule 14A of the 1934 Act, together with a form of proxy on which the security holder can indicate his or her approval or disapproval of each proposal expected to be presented at the meeting.[258]

When securities are held in the names of brokers, banks, or nominees, the registrant or issuer company must inquire as to the beneficial ownership of the securities, furnish sufficient copies of the proxy statement for distribution to all of the beneficial owners, and pay the reasonable expenses of such distribution.

In connection with any solicitation of a proxy (or other form of consent or authorisation by shareholders) directed to more than 10 persons, a proxy statement and proxy form complying with the proxy rules must be filed with the Securities and Exchange Commission if the solicitation pertains to a security registered under the 1934 Act.[259] The annual election of directors for a company whose common stock is registered under the 1934 Act normally gives rise to an obligation to file and use a proxy statement in connection with the solicitation of proxies.[260] The proxy statement sets forth:

- The names of nominees for election to the board;
- The date when they first became directors;
- Their shareholdings; and
- The compensation of and transactions with officers and directors during the past year.

The proxy relating to the election of directors must list the nominees for whom proxies are being solicited and afford shareholders an opportunity to withhold their vote as to all or specified nominees.[261] Moreover, the directives of item 402 of Regulation S-K mandate extensive disclosure related to executive compensation and compensation tables. Additionally, there are disclosure requirements which require:

- A board compensation committee report on executive compensation;
- A performance graph, which must compare the issuer's total shareholder return with certain specified performance indicators;
- An option re-pricing disclosure; and
- Information relating to proxy rule amendments changing the disclosure requirements that apply if shareholder action is being taken with respect to employee benefit plans.

The preliminary proxy statement and proxy must be filed with the Securities and Exchange Commission at least 10 calendar days before the definitive proxy statement and proxy are to be distributed in connection with shareholder action. This requirement for

258 Securities and Exchange Act of 1934, 15 United States Code, s 78n; 17 Code of Federal Regulations, s 240.14a-3.4.
259 17 Code of Federal Regulations, s 240.14a-6.
260 17 Code of Federal Regulations, s 240.14a-3.
261 17 Code of Federal Regulations, s 240.14a-4(b)(2).

preliminary filing does not apply if the proxy statement and proxy relate only to an annual or special meeting at which only the election of directors and related routine matters are to take place.[262] As noted above, when the proxies are being solicited for use at an annual meeting for election of directors, the proxy statement must be accompanied by an annual report to the shareholders.

Short-Swing Trading

Securities registered by a foreign private issuer eligible to use Form 20-F are exempt from the short-swing profit provisions of the 1934 Act.[263]

As a result, non-United States persons holding securities in a foreign private issuer are exempt from the provisions of section 16 which require disgorgement of the profits from the purchase and sale, or any sale and purchase, of any equity securities of such issuer within six months and do not need to file Form 3, Form 4, or Form 5 required thereunder to disclose persons with beneficial ownership of more than 10 per cent of any class of securities and the beneficial ownership of officers and directors.[264]

Take-Over Provisions; Disclosure of Beneficial Ownership of United States Issuer

A non-United States person holding securities of a non-United States or United States issuer is required to file notice of the acquisition, directly or indirectly, of the beneficial ownership of more than five per cent of any equity security of a class registered pursuant to section 12 of the 1934 Act, within 10 days after such acquisition.[265] These provisions were enacted to prevent creeping take-overs by undisclosed principals of United States companies with a class of securities listed pursuant to section 12.

The provisions are part of what is commonly referred to as the Williams Act, a series of statutes and rules that regulate the conduct of management, bidders, and broker-dealers in a hostile take-over. For purposes of this rule, a beneficial owner includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares:

- Voting power, which includes the power to vote, or to direct the voting of, such security; or
- Investment power, which includes the power to dispose, or to direct the disposition of, such security.[266]

In addition, a person is deemed to be the beneficial owner of a security if that person has the right to acquire such security within 60 days through any option, warrant or right to

262 17 Code of Federal Regulations, s 240.14a-6(a).
263 17 Code of Federal Regulations, s 240.3a12-3(b).
264 Securities and Exchange Act of 1934, 15 United States Code, s 78p; 17 Code of Federal Regulations, ss 240.16a-1 *et seq*.
265 17 Code of Federal Regulations, ss 240.13d-1 *et seq*.
266 17 Code of Federal Regulations, s 240.13d-3.

conversion of a security, pursuant to power to revoke a trust, discretionary account, or similar arrangement, or any automatic termination of a trust, discretionary account, or similar arrangement.[267] All securities held by persons acting as a group are aggregated for purposes of determining whether the five per cent disclosure trigger has been reached. A group is defined as when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer.[268]

Multi-Jurisdictional Disclosure System for Canadian Issuers

Based on the close relationship between the United States and Canada, in 1991 the Securities and Exchange Commission adopted the Multi-Jurisdictional Disclosure System, which permits certain Canadian issuers to offer publicly and to sell their securities in the United States using documentation prepared in accordance with the requirements of Canadian law and reviewed by provincial securities regulators.

Likewise, Canadian securities administrators adopted a similar provision that extended the same system for United States issuers.[269] In short, these systems were intended to permit United States and Canadian issuers to comply with their local disclosure requirements and make securities offerings in the other country.[270]

'Substantial' Canadian companies with a three-year reporting history in Canada are permitted to use documents prepared according to Canadian securities laws to register securities with the United States Securities and Exchange Commission and meet the periodic reporting requirements. In addition, under the Multi-Jurisdictional Disclosure System, Canadian companies registered thereunder are exempt from the Securities and Exchange Commission's proxy requirements. Substantial Canadian companies include companies that are incorporated in Canada and have either:

- A total market value for common stock of Cdn $180 million and a public float of US $75 million and are eligible to use the F-9 registration form for investment grade debt and preferred stock offerings; or
- A market value for common stock of Cdn $360 million and a public float of US $75 million and are eligible to use the F-10 registration form for equity offerings.[271]

The Securities and Exchange Commission's willingness to harmonise United States and Canadian requirements was largely based on the similarities between United States and Canadian securities regulations and accounting and auditing standards as well as the

267 17 Code of Federal Regulations, s 240.13d-3.
268 Securities and Exchange Act of 1934, 15 United States Code, s 78m.
269 The Multi-Jurisdictional Disclosure System concept of mutual recognition also allows certain cash tender and exchange offers in the United States for securities of Canadian issuers to proceed in accordance with Canadian, provincial, and territorial tender offer requirements.
270 Securities Act Release 7606A, Exchange Act Release 40632A, International Series Release Number 1167A (13 November 1999); Canadian Securities Administrators, National Policy Statement Number 45.
271 Securities Act Release Number 6841 (24 July 1989), 54 Fed Reg 32,226, at 32,241.

existence of a Memorandum of Understanding concerning mutual co-operation in matters relating to the administration and enforcement of United States and Canadian securities laws.[272]

The Multi-Jurisdictional Disclosure System is significant because it represents the first time that the Securities and Exchange Commission has been willing to accept documentation prepared in accordance with securities law requirements of a non-United States jurisdiction for use in registered public offerings made in the United States. This was a precursor to the harmonisation that is intended by the International Organisation of Securities Commissions standards.

Under the Multi-Jurisdictional Disclosure System, eligible issuers can more easily conduct cross border offerings in Canada and the United States because they prepare only one set of registration documents and are allowed to use one offering document in selling securities in both Canada and the United States. Among the forms used for disclosure for Canadian issuers under the 1933 Act are Forms F-7, F-8, F-9, F-10, and F-80.[273]

Jurisdictional Conflicts

Subject Matter Jurisdiction

Just as the United States securities law is comprised of a combination of Congressional Acts and regulations promulgated thereunder by the Securities and Exchange Commission, so are the rules concerning the litigation of disputes under the securities laws. However, prior to determining in which court a dispute under the United States securities laws should be brought, it must be determined if the securities laws will be applicable.

This determination will be based on whether the necessary 'jurisdictional means' have been used directly or indirectly in connection with the securities transaction in question. In general, for purposes of the securities laws, the necessary jurisdictional means include the use of any means or instrumentality of transportation or communication in interstate commerce or of the mails.[274]

In addition, sections 9(a) and 10 of the 1934 Act designate the use of the facility of any national securities exchange or market as a bridge to Commission jurisdiction. Due to the broad nature of the necessary jurisdictional means, it is generally not difficult to establish this jurisdictional means, however, this pleading requirement must be alleged and established in every case.

Once it is established that the necessary jurisdictional means have been used, one must then determine the appropriate forum in which to bring the dispute. The question of federal or state jurisdiction is determined by the nature of the claims to be litigated. In certain instances, jurisdiction will lie exclusively with the federal courts.

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272 Securities Act Release Number 6841 (24 July 1989), 54 Fed Reg 32,226, at 32,231.
273 17 Code of Federal Regulations, ss 239.37–239.380.
274 Securities and Exchange Act of 1934, 15 United States Code, ss 77e, 77l, and 77q; 15 United States Code, ss 78i(a), 78j, 78o(c)(1), and 78o(c)(2).

For example, jurisdiction over any appeal from an administrative decision of the Securities and Exchange Commission will lie exclusively with the federal courts,[275] as will that over criminal proceedings and Securities and Exchange Commission enforcement actions.[276]

Moreover, federal courts have exclusive jurisdiction over all suits in law or equity to enforce claims arising under the 1934 Act and the applicable Commission rules.[277] Thus, any claim under the 1934 Act brought in a state court will be barred.[278] The exclusivity of federal jurisdiction is applicable even if the complaint does not specifically allege violations of the 1934 Act; it merely must allege facts that resemble a 1934 Act claim.

In contrast, jurisdiction over civil actions arising under the 1933 Act will lie concurrently in the federal and the state courts.[279] This rule is taken a step further under the 1933 Act, in that, if an action under the 1933 Act is brought in a state court, the action may not be removed to the federal court level.[280]

One commentator has stated that the justification for this rule is the facilitation of private enforcement by giving the plaintiff an absolute choice of forum; especially since, in many cases, state court litigation may prove less complex and less expensive than suits in federal court.[281]

Procedural Requirements

In General

Although a discussion of all of the procedural requirements involved in the litigation of a securities case is beyond the scope of this chapter, the following is a summary of the major procedures involved in securities litigation.

Venue

The rules as to proper venue (ie, the court in which litigation may be brought, whether it be at the state or the federal level) are set forth in the securities laws. Section 22(a) of the 1933 Act and section 27 of the 1934 Act provide that an action may be brought in the district in which the defendant is found or is an inhabitant or transacts business.

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275 Securities and Exchange Act of 1934, 15 United States Code, s 77I; 15 United States Code, s 78y.

276 Securities and Exchange Act of 1934, 15 United States Code, s 77v, and 15 United States Code, s 78aa.

277 Securities and Exchange Act of 1934, 15 United States Code, s 78aa.

278 *Riley* v *Simmons*, 45 F3d 764 (3d Cir, 1995); *Evans v Dale*, 896 F2d 975 (5th Cir, 1990); *Kleckley* v *Hebert*, 464 So 2d 39 (La App, 1985).

279 Securities Act of 1933, 15 United States Code, s 77v(a).

280 Securities Act of 1933, 15 United States Code, s 77v(a).

281 Hacker and Rotunda, 'The Extraterritorial Regulation of Foreign Business under the United States Securities Laws', 59 *NCL Rev* 643 (1981), s 14.1, at p 49.

Furthermore, for purposes of an action brought under the 1933 Act, venue is proper in any district in which an offer or sale took place, if the defendant participated therein.[282]

Service of Process

Generally, process may be served on, and personal jurisdiction over the defendant established, by serving the defendant in any district in which he or she is an inhabitant or in which he or she may be found.[283]

However, as various jurisdictions may present certain nuances or other unique requirements, potential parties to any action should consult with local counsel regarding the specifics of that particular jurisdiction relating to personal jurisdiction.

Statutes of Limitation

The securities laws provide specifically for statutes of limitations when express remedies are set forth. However, as to actions brought under rule 10b-5, no specific statute of limitations exists, since the remedy it provides is only an implied remedy for damages in private actions brought by a purchaser or seller of a security. This lack of a statute of limitations led to a significant amount of litigation, with the Federal Circuits split as to what statute of limitations should be applied by analogy.

Finally, the Supreme Court, in *Lampf, Leva Lipkind, Prupis and Petigrow* v *Gilbertson*,[284] through a myriad of five different opinions, held that the proper statute of limitations should be one year after discovery, limited by a three-year statute of repose, analogising to the other similar statutes of limitations contained in the securities laws. It should be noted, however, that, after the Supreme Court's decision in *Lampf*, Congress promulgated section 27A of the 1934 Act to quash any retroactive application of this statute of limitations to cases initiated on or before 19 June 1991, the day before the court's decision.[285]

Damages

As with statutes of limitations, a dichotomy exists as to the provision for damages between the express remedies of the securities laws and the implied remedy in rule 10b-5 promulgated under section 10 of the 1934 Act. For example, if a suit is brought by a person under section 11 of the 1933 Act due to the acquisition of a security through a registration statement containing an untrue statement or omission of material fact, such person's damages are limited to the difference between the amount paid for such security (not exceeding the public offering price) and the price at which it was disposed prior to the initiation of the suit.[286] Similarly, section 12 of the 1933 Act provides a specific limit on damages in the case of violations of sections 3 or 5 of the 1933 Act, namely:

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282 15 United States Code, s 77v(a); 15 United States Code, s 78aa.
283 15 United States Code, s 77v; 15 United States Code, s 78aa.
284 *Lampf*, *Leva Lipkind*, *Prupis and Petigrow* v *Gilbertson*, 111 SCt 2773, at p 2780 (1991), *reh'g denied*, 501 US 1277 (1991).
285 15 United States Code, s 78aa-1.
286 15 United States Code, s 77k(e).

- If the plaintiff has not disposed of the security, the amount paid for the security in question plus interest less any income received thereon, on the tendering of the security; or
- If the security has already been sold, the difference between the purchase price and the amount received on disposition.[287]

In the case of a rule 10b-5 action, the limitation of damages is set forth under the case law. In general, the purchaser in such an action may either rescind the purchase or recover the difference between the purchase price of the security in question and the real value of the security, plus interest.[288] However, if the plaintiff has already disposed of the security, damages will be limited to the difference between the purchase price and the price at which the security was sold.[289]

In the case of a defrauded seller, such seller will be able to recover the difference between the amount received on the sale and the purchase price received by the purchaser on resale.[290] Finally, it should be noted that a plaintiff cannot recover punitive damages under the United States securities laws.[291]

Conclusion

The United States securities laws are a complex set of statutes, rules, regulations, judicial interpretations, and practices that have evolved since modern securities law concepts were first enacted in the 1930s. Underlying the extensive regulation is the goal to protect the investor by mandating adequate and fair disclosure so that appropriate investment decisions can be made.

Over time, the United States securities laws have been adapted for the non-United States issuer, as world financial markets have become more integrated and internationalised. Leading the way has been the Securities and Exchange Commission, which, through various initiatives, has sought to include non-United States issuers within the regulatory framework and has worked to instill in other non-United States markets the concepts of the United States regulatory scheme.

The benefits of the United States markets to non-United States companies, in terms of relatively fair valuations, liquid markets, political stability, and evenly administrated regulatory schemes, are substantial. The enforcement activities of the Securities and Exchange Commission, and self-regulatory organisations, ensure compliance with the law and deter fraudulent conduct. The United States is a leading jurisdiction in attracting non-domestic companies to its capital markets. All indications are that this trend will continue.

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287 Securities Act of 1933, 15 United States Code, s 77l(a).
288 *Sackett* v *Beaman*, 399 F2d 884 (2nd Cir, 1968).
289 *Clark* v *John Lamula Investors*, *Inc*, 583 F2d 594 (2nd Cir, 1978).
290 *Janigan* v *Taylor*, 344 F2d 781, 786 (1st Cir, 1965), *cert denied*, 382 US 879 (1965).
291 *Globus* v *Law Research Serv*, *Inc*, 418 F2d 1276 (2nd Cir, 1969), *cert denied*, 397 US 913 (1970).

Venezuela

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Venezuela

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Introduction

Regulatory System

Major changes have affected the capital markets area in Venezuela in recent years. The main legal instrument regulating securities and exchange was the Capital Markets Law (*Ley de Mercado de Capitales),* which was originally enacted in 1973 and amended in 1975 and in 1998[1] (the "Abrogated Law"). The Abrogated Law was replaced in August 2010 by the Securities Market Law (*Ley del Mercado de Valores[2])*, which was later reprinted to correct "material errors" in November 2010*,* (the "Securities Market Law"),[3] and is currently in force.

In general, the Securities Market Law allows companies to raise funds from the public by means of issuing and placing securities, under the supervision of the National Superintendence of Securities (*Superintendencia Nacional de Valores*, the "Superintendence"). The Securities Market Law regulates the following:

- The Superintendence and its functions;
- Securities that are to be publicly offered;
- Issuers;
- Brokers;
- Investment advisers; and
- Investor protection.

The Securities Market Law defines securities in a broad manner[4] in article 16, where it states:

> "It will be understood as securities, for the purposes of this law, the financial instruments which represent property or credit rights over the

1 *Official Gazette* Number 36.565 of 10 October 1998.
2 *Official Gazette* Number 39.489 of 17 August 2010.
3 *Official Gazette* Number 39.546 of 5 November 2010.
4 This is contrary to the Abrogated Law, which defined securities simply as "corporations' shares, obligations and any other securities issued in masse that have the same characteristics and grant their holders the same rights within their class".

equity of a corporation, short, medium, or long term, issued *en masse*, which have the same characteristics and grant their holders the same rights within their class. The National Superintendence of Securities, in cases of doubt, shall determine which are the securities regulated by this Law:

". . . derivative instruments, different types of instruments or securities representing a right of option for the purchase or sale of securities and futures contracts on securities, where the parties agree to buy or sell a given amount of securities at a predetermined price and date, and generally any other type of instrument the value of which is determined and fixed by reference to the value of other assets or group of them."

" …securities which represent property rights, warranties and other rights or contracts on agricultural products and supplies."

A public offer is defined in article 17 of the Securities Market Law as "the offer made to the public, to given sectors or groups by any advertising or broadcasting means". This definition is quite vague, so the same article states that, in case of "doubt regarding the nature of the offering", the Superintendence has the power to decide whether it is a public offer or a private offer.[5]

If there is a public offer, an authorization granted by the Superintendence is needed. The granting of this authorization takes time and is subject to meeting certain legal requirements. An individual or corporation that provides investment advice or brokerage services in Venezuela must have a license as an investment adviser or as a securities broker, as the case may be, issued by the Superintendence.

In June 2010, the National Financial System Organic Law (*Ley Orgánica del Sistema Financiero Nacional,*[6] the "Financial System Law") was enacted and, in December 2010, it was amended in order to correct a "material error". This law created the Superior Organ for the National Financial System (*Órgano Superior del Sistema Financiero Nacional*, Osfin). Osfin's role is to regulate, supervise, control, and coordinate the national financial system, which comprises:

- The banks and other entities that operate in the banking sector;
- The insurers and other entities that operate in the insurance sector; and
- The brokerage houses and other entities that operate in the capital markets sector.

The Financial System Law, which provides for the creation of Osfin, states that, until Osfin is in a position to assume its role, it will be undertaken by the Ministry of Finance. The Financial System Law further provides that the

5 Securities Market Law, art 17.

6 *Official Gazette* Number 39,447 of 16 June 2010 and amended as published in *Official Gazette* Number 39.578 of 21 December 2010.

regulatory agencies for each of those areas, including the Superintendence, shall coexist with and be coordinated by Osfin, which has the power to:

- Issue binding opinions;
- Issue regulations; and
- Establish penalties.

A state-owned stock exchange, the Bicentenary Public Stock Exchange, was created in November 2010 by the Law of the Bicentenary Public Stock Exchange (*Ley de la Bolsa Pública de Valores Bicentenaria*[7]). The Caracas Stock Exchange, a private forum which started operations in 1947, continues its activities, regulated by the General Regulations of the Caracas Stock Exchange (*Reglamento General de la Bolsa de Valores de Caracas, C.A.*[8]). However, even though there are now two active stock exchanges in Venezuela, the Venezuelan stock market is very diminished due to political and economic reasons.

The regulation regarding securities, especially from the point of view of international transactions, has been further complicated because, since February 2003 there has been an exchange control system in force, which further regulates and limits the activities of the capital markets actors, whether national or international. In addition, in September 2005, the Law Against Illicit Exchanges (*Ley contra los Ilícitos Cambiarios)* was passed, criminalizing foreign exchange transactions outside the regulations, and in December 2007 a new Law Against Illicit Exchanges was enacted. The Law Against Illicit Exchanges was modified in February 2008, and a new amendment was approved in May 2010 (the "Illicit Exchanges Law"[9]). The Illicit Exchanges Law was abrogated in February 2014 by the less restrictive Exchange Controls Decree-Law (*Decreto Ley del Régimen Cambiario y sus Ilícitos,*[10] the "Exchange Controls Decree-Law").

Therefore, legally valid access to foreign currency is severely limited in Venezuela, in accordance with the exchange controls regulations, under the administrative office in charge of exchange control matters, the *Centro Nacional de Comercio Exterior* ("Cencoex"), created in 2013[11], which in 2014 took over the exchange controls administration, upon the suppression of the *Comisión de Administración de Divisas* ("Cadivi") by the Exchange Controls Decree-Law.

From 2003 until 2009, there was only one official exchange rate, which varied from time to time. However, from 2005 to 2009, the official exchange rate was

7 *Official Gazette* Number 5.999 E of 13 November 2010.
8 *Official Gazette* Number 39.096 of 12 January 2009.
9 *Official Gazette* Number 5.975 E of 17 May 2010.
10 *Official Gazette* Number 6.126 E of 19 February 2014.
11 *Official Gazette* Number 6.116 E of 29 November 2013.

kept at the artificially low rate of VEF 2.15 per US dollar.[12] In January 2010, two official exchange rates were established: VEF 2.6 and VEF 4.3. In January 2011, the official exchange rate was unified at VEF 4.3. And, in February 2013, the official exchange rate was raised to VEF 6.3. At the present time, July 2014, in addition to the official exchange rate of VEF 6.30 per USD, which is a fixed rate, there are two other official exchange rates, which vary from day to day: (i) the Sicad rate, of approximately VEF 10 per USD (which was implemented in early 2013, and applies only to very limited transactions); and (ii) the new Sicad II rate of approximately VEF 50 per USD. The Sicad II rate is the result of a new system for the distribution and allocation of foreign currency, the *Sistema Cambiario Alternativo* (SICAD II), implemented in March 2014 by means of an agreement between the Venezuelan Central Bank and the Ministry of Popular Power for the Economy, Finances and Public Banks, the *Convenio Cambiario N° 27*[13] (the "Sicad II Regulations"). The Sicad II Regulations theoretically allow the sale and purchase of foreign currency for whatever purposes the buyer wishes. In practice, the internal mechanisms used by the exchange controls authorities to allocate and distribute foreign currency within the Sicad II system, to eventual sellers and buyers, are not clearly defined, so — although a great improvement — the Sicad II rate is not reached by means of a transparent mechanism of exchange. Both the Sicad rate and the Sicad II rate are published daily by the Central Bank. In all cases, except for the Sicad II system (which in practice is of limited and discretional access), foreign currency at the official exchange rates is only available for very specific matters and requires an authorization issued by Cencoex.

Until May 2010, an additional way of legally acquiring foreign currency was the parallel market, or "permuta" market, where individuals and corporations were able to acquire a bond denominated in local currency for a price in local currency, exchange such bond for a bond denominated in foreign currency, and sell the latter bond for a price in foreign currency, or vice versa, by means of transactions made through local brokers and their correspondents abroad, with no restrictions as to the amounts to be sold/acquired or to the origin or destination of the funds. The "permuta" market created a very important segment of work for brokers. However, in the last reform of the Illicit Exchanges Law in 2010, the "permuta" market was forbidden, and brokers were not allowed to participate in exchange controls transactions. In a significant change of course, the Exchange Controls Decree-Law and the Sicad II Regulations now permit the participation of brokers in currency exchange transactions, which include the purchase and sale of bonds.

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12 In January 2008, there was a change in the currency of Venezuela, by means of which the former bolívar (Bs) was turned into the *bolívar fuerte* (BsF, VEF), by dividing it by 1,000. Therefore, from 2005 to 2008, the rate of exchange was Bs 2,150 per US dollar and, from January 2008 to January 2010, the official exchange rate was of VEF 2.15 per US dollar.

13 *Official Gazette* Number 40.368 of 10 March 2014.

Legal Sources

Relevant legislation includes:

- The Exchange Controls Decree-Law[14] and the Illicit Exchanges Law;[15]
- The Law of the Bicentenary Public Stock Exchange;[16]
- The Securities Market Law and the Abrogated Law;[17]
- The Organic Law of Administrative Procedures;[18]
- The Financial System Law:[19]
- The Authorization Regulations;[20]
- The Economic and Financial Disclosure Rules;[21]
- The Public Offer Rules;[22]
- The Transparency Rules;[23]
- The Rules on Fees;[24]
- The Take-Over Rules;[25]
- The General Regulations of the Caracas Stock Exchange;[26] and
- The Sicad II Regulations.[27]

Authorities

The regulatory agency under the Securities Market Law is the Superintendence. Under the Abrogated Law, the regulatory agency was the *Comisión Nacional de Valores* (the "Commission"), now replaced by the Superintendence.

The Superintendence is "coordinated" by Osfin, under article 14 of the Financial Systems Law, which includes among Osfin's competencies "the coordination of the regulating entities of the National Financial System, in order to avoid

14 *Official Gazette* Number 6.126 E of 19 February 2014.
15 *Official Gazette* Number 5.975 E of 17 May 2010.
16 *Official Gazette* Number 5.999 E of 13 November 2010.
17 *Official Gazette* Number 36.565 of 10 October 1998.
18 *Official Gazette* Number E 2.818 of 1 July 1981.
19 *Official Gazette* Number 39,447 of 16 June 2010, as amended and published in *Official Gazette* Number 39.578 of 21 December 2010.
20 *Official Gazette* Number 39.071 of 2 December 2008.
21 *Official Gazette* Number 39.574 of 15 December 2010.
22 *Official Gazette* Number 39.585 of 3 January 2011.
23 *Official Gazette* Number 36.650 of 26 February 1999.
24 *Official Gazette* Number 39.720 of 25 July 2011.
25 *Official Gazette* Number 37.039 of 19 September 2000.
26 *Official Gazette* Number 39.096 of 12 January 2009.
27 *Official Gazette* Number 40.368 of 10 March 2014.

distortions in the development of the intermediation activities of the supervised entities".[28]

Although not immediately related to the capital markets area, in view of the exchange control in force in Venezuela, one must mention the corresponding administrative authority, Cencoex, as well as the Central Bank of Venezuela, which oversees Sicad and Sicad II.

Procedures

The Securities Market Laws establishes the National Securities Registry (*Registro Nacional de Valores),* which is defined as follows:

> "Article 15. National Securities Registry.- The files where shall be inscribed or recorded all the acts relative to the persons and securities subject to this Law constitute the National Registry of Securities. The National Securities Superintendence shall dictate the rules for its operation."[29]

Therefore, under the Securities Market Law, securities that are to be publicly offered must be registered, as well as issuers, brokers,[30] investment advisers, stock exchanges, risk-rating agencies, and other entities regulated by the Law.[31] In order to be registered, all of the above must be approved by the Superintendence following procedures that are dictated by the Superintendence. The Securities Market Law has made major changes to the matters under regulation, including significant issues with regard to brokers and investment advisers, among others. In many cases, the Securities Market Law has provided that the Superintendence must issue further rules (*normas)* to regulate specific matters.

Unfortunately, the Superintendence has not issued the regulations that are needed in order to comply with the terms of the Securities Market Law and, in some cases, such as with investment advisers (see text, below), the magnitude of the changes imposed by the Securities Market Law are such that the previous regulations are no longer applicable; thus, there is a legal vacuum regarding certain procedures. In this chapter, we shall also cover the public take-over bids procedure.

Legal Order and Regulatory Interests

Admission

Market Participants

In General. As expressed above, an individual or corporation that provides investment advice or brokerage services in Venezuela must be licensed by the

28 Financial System Law, art 14.5.

29 Securities Market Law, art 15.

30 Among the changes made by the Securities Market Law is that securities brokers, who were called as such (*corredores de valores),* now are called "authorized securities operators" (*operadores de valores autorizados).*

31 Securities Market Law, art 19.

Superintendence as an investment adviser or as a broker. Issuers of securities that are to be publicly offered must also be registered.

Investment Advisers. Investment advisers are regulated in article 22 of the Securities Market Law as follows:

> "Article 22.- Nationals or foreign persons who have studied securities and their issuers, and who express opinions regarding them whether publicly or privately shall be considered investment advisers. Investment advisers are not allowed to receive, directly or indirectly, funds or securities from its clients, except for their fees.
>
> "Investment advisers must obtain authorization from the National Superintendence of Securities. To that effect, the Superintendence must dictate the regulations regarding the authorization and the activities of the investment advisers."[32]

In general, the wording of the Securities Market Law is deficient. This is very evident in article 22, which regulates investment advisers and makes no distinction between individuals and corporations. The wording "who have studied securities and its issuers" could be taken to mean that only individuals, as opposed to corporations, can be considered investment advisers. However, article 8 of the Securities Market Law, when listing the powers and duties of the Superintendence, provides that it will "dictate the regulations according to which companies incorporated in the Republic, abroad, or individuals dedicated to advising on securities investment may operate within the national territory".[33] Therefore, foreign nationals and corporations incorporated abroad are allowed to be registered as Investment Advisers. There are no exemptions from registration requirements for Investment Advisers already registered in another jurisdiction.

The definition contained in article 22 of the Securities Market Law is very broad, and thus substantially changes the regulations for investment advisers that had been in force in Venezuela. Under the Abrogated Law, investment advisers were required to be licensed by the Commission if their "principal object is to advise the public regarding investment in the capital markets".[34] In addition, article 84 of the Abrogated Law established the following:

> "Persons who intend to habitually perform advisory functions for the acquisition of foreign securities, or serve as a direct or indirect contact with financial intermediaries or public stockbrokers operating abroad, must obtain the respective authorization of the National Commission on Securities, which shall establish the registration regulations for such activities to be carried out in the country."

32 Securities Market Law, art 22.
33 Securities Market Law, art 8(14).
34 Abrogated Law, art 85.

Under the legislation now in force, the Securities Market Law, anyone who provides investment advice in Venezuela, whether publicly or privately, must be licensed by the Superintendence. Indeed, according to the Law, anyone who has studied the subject of securities and its issuers, and expresses an opinion regarding such subjects, must be licensed by the Superintendence. The most important distinction made by the Abrogated Law, that the advice had to be provided "habitually" and that it had to be the "principal object" of the activities of the investment adviser, is no longer valid.

Under the Abrogated Law, the Commission issued the Rules Regarding the Authorization and Registration of Brokers and Investment Advisers (*Normas Relativas a la Autorización y Registro de los Corredores Públicos de Valores y Asesores de Inversión,*[35] the "Authorization Regulations"). The Authorization Regulations complied with the Abrogated Law, and specifically required that the advice should be provided "habitually".

However, in view of the fact that the Superintendence has yet to issue the rules regarding authorizations under the Securities Market Law, the Authorization Regulations should apply only in those matters that do not contradict the Securities Market Law. For instance, according to the Authorization Regulations, individuals who request an authorization must be over 35 years of age, have a graduate title, take and pass an examination administered by the Commission (now the Superintendence), or obtain a waiver from it based upon their qualifications obtained abroad. This does not contradict the Securities Market Law.

The Abrogated Law established indirectly the acceptance of foreign Investment Advisers, since the functions of the Commission included the following text: "Dictate the rules according to which companies domiciled abroad may operate in the national territory . . .".[36] However, the Authorization Regulations contain no provisions for the authorization of legal entities incorporated abroad. It simply states that companies that are not incorporated or domiciled in Venezuela may not be authorized as investment advisors. In the case of corporations, the Authorization Regulations required that such entities had to be in the form of a Venezuelan *sociedad anónima* (limited-liability company), and their exclusive object should be solely to provide investment advice.

In contrast, the Securities Market Law expressly accepts foreign Investment Advisers in the article that defines them, which refers to "Nationals or foreign persons who have studied securities and their issuers, and who express opinions regarding them whether publicly or privately". In addition, and similarly to the Abrogated Law, it indicates that the Superintendence shall issue "the regulations according to which companies incorporated in the Republic or abroad . . . may operate within the national territory".[37]

35 *Official Gazette* Number 39.071 of 2 December 2008.
36 Abrogated Law, art 9(8).
37 Securities Market Law, art 8(14).

The Abrogated Law and the Authorization Regulations required that corporations must render their services through individuals who must have been duly authorized as Investment Advisers by the Commission (now the Superintendence); this requirement also is implicit in the wording of the Securities Market Law.

There is a registration fee, which was set by the Superintendence in January 2011, by means of the Regulations Regarding Duties and Contributions, that must be paid by persons under the control of the Superintendence[38] (*Normas Relativas a las Tasas y Contribuciones que deben cancelar las Personas sometidas al Control de esta Superintendencia,* the "Rules on Fees"). Investment advisers who are individuals must pay 100 tributary units[39] and corporations must pay 200 tributary units.[40] The tributary unit changes yearly, in order to adapt to the inflation rate;[41] as of January 2014, it was set at VEF 127.

In addition, investment advisers must pay a "special yearly contribution" to the Superintendence, as established in the Rules on Fees. If the investment adviser is an individual, the special contribution is of 100 tributary units.[42] If the adviser is a corporation, it must pay 1,000 tributary units.[43] The special contribution must be paid upon registration, and then yearly within the first 15 days of January.

There is no established time frame for the Superintendence to register an investment adviser, or even to reply to its request. In view of the recent changes in legislation, and since no new regulations have been issued to comply with the Securities Market Law, it is difficult to estimate how long registration will now require (under the Abrogated Law and the Authorization Regulations, it took many months).

The Organic Law of Administrative Procedures[44] (*Ley Orgánica de Procedimientos Administrativos),* which governs procedures not covered by specific laws or regulations, provides that "the processing and resolution of files" may not exceed four months that, in exceptional cases, may be extended for two additional months".[45] However, in practice, the term is not applied by the Superintendence.

As stated above, with regard to foreign individuals or corporations who wish to register as investment advisers, the Securities Market Law provides that the Superintendence must "dictate the regulations according to which companies

38 *Official Gazette* Number 39.720 of 25 July 2011.
39 Rules on Fees, art 1, para 2(4).
40 Rules on Fees, art 1, para 2(3).
41 In 2010, the official inflation rate was of 27.2 per cent (as indicated by the Central Bank of Venezuela).
42 Rules on Fees, art 1(e).
43 Rules on Fees, art 1(d).
44 *Official Gazette* Number E 2.818 of 1 July 1981.
45 Organic Law of Administrative Procedures, art 60.

incorporated in the Republic, abroad, or individuals dedicated to advising on securities investment may operate within the national territory". The Superintendence has yet to comply and there has been no announcement regarding the regulations to be issued. In practice, the Superintendence's website list of registered investment advisers includes 125 individuals[46] and eight corporations.[47] The Superintendence's Annual Report for 2013 has no record of new investment advisers being admitted; whereas it indicates that the inscriptions of eight investment advisers were cancelled.

Brokers. According to the Securities Market Law, brokers (*corredores públicos de valores*) are now denominated "authorized securities operators" (*operadores de valores autorizados*). Article 20 of the Securities Market Law defines the concept of brokers as follows:

> "Authorized securities operators: Individuals or corporations who habitually or regularly engage in the performance of activities of intermediation with securities in the primary or secondary securities market, or in the raising of funds or securities for investment in securities regulated by this Law, in their own name and their own account, or on account of a third party, or in the name and account of a third party."[48]

The article further states that brokers may adopt the form of corporations and may be shareholding members of a stock exchange. The Abrogated Law did not define brokers; it only established that persons who engaged in brokerage operations, whether within or outside a stock exchange, had to request authorization from the Commission.

According to the Securities Market Law, all brokers (even those who were previously authorized under the Abrogated Law) must request from the Superintendence an authorization to act as such authorized securities operators within 180 days from the entry into force of the Securities Market Law, which may be prorogued for a further 180 days, during which period they may act as "temporary" brokers.[49]

With regard to non-Venezuelan individual or corporate brokers, the Securities Market Law's definition of brokers does not expressly state that they may be foreign. However, when establishing the functions of the Superintendence, it provides that the latter must issue "the regulations according to which individuals or companies incorporated in the Republic or abroad . . . may operate within the national territory".[50] These regulations have yet to be issued.

The Authorization Regulations, issued under the Abrogated Law, required that corporate brokers had to be in the form of a Venezuelan *sociedad anónima*

46 http://www.snv.gob.ve/snv/rnv/adi.php.
47 http://www.snv.gob.ve/snv/rnv/consultaempresasjuridicas.php?tipo_empresa=4.
48 Securities Market Law, art 20.
49 Transitory Provision, Securities Market Law.
50 Securities Market Law, art 8(14).

(limited-liability company) and their exclusive object should have been to act solely as securities intermediaries.[51]

Article 20 of the Securities Market Law also establishes that the Superintendence may dictate the norms that will regulate the brokers, regarding not only the authorization to act as brokers, but also all the activities performed as such, the technical requirements of solvency and liquidity, the financial information, and the transfer of shares of broker corporations.

Brokers are supervised by the Superintendence, which must authorize and supervise their acts as provided in article 8(1) of the Securities Market Law that establishes the latter's functions. Among the supervisory faculties of the Superintendence is that it may revoke or suspend the broker's authorization and cancel the inscription in case of a grave violation of the norms that regulate their activities. The law does not specify what it considers to be a grave violation of the norms. The Securities Market Law provides that brokers may not:

- Perform and register simulated operations;
- Execute operations without a transfer of securities;
- Liquidate its operations outside the official site of the stock exchange; or
- Perform intermediacy operations for the banking and insurance sectors.[52]

The Securities Market Law also establishes that brokers may not deal with national public debt bonds.[53] However, after the Securities Market Law was enacted, the following has happened: (i) the Exchange Controls Decree-Law now permits the participation of brokers in exchange operations;[54] (ii) the Sicad II Regulations expressly indicate that Sicad II operations may be transacted through "institutions authorized to act in the securities markets, in accordance with the Securities Market Law";[55] and (iii) the Superintendence has issued the Instructions for the Participation in the Alternative Exchange of Foreign Currency System (SICAD II) of Authorized Securities Operations[56] and a list of brokers so authorized.[57] Therefore, the relevant provision of the Securities Market Law has been abrogated, and brokers are now allowed to participate in exchange transactions, which include national public debt bonds.

As with investment advisers, there is a registration fee, set by the Rules on Fees. Brokers who are individuals must pay 100 tributary units;[58] corporations must pay 200 tributary units.[59]

51 Authorization Regulations, art 7.
52 Securities Market Law, art 27.
53 Securities Market Law, art 2.
54 Exchange Controls Decree-Law, art 10.
55 Sicad II Regulations, article 4.
56 *Official Gazette* Number 40.387 of 4 April 2014.
57 *Official Gazette* Number 40.457 of 18 July 2014.
58 Rules on Fees, art 1, para 2(4).

In addition, brokers must pay a "special yearly contribution" to the Superintendence, as established in the Regulations Regarding Duties and Contributions. If the broker is an individual, the special contribution is 100 tributary units.[60] If the broker is a corporation, it must pay 1,000 tributary units.[61] The special contribution must be paid upon registration, and then yearly with the first 15 days of January.

As with investment advisers, there is no established time frame for the Superintendence to register a broker, or to reply to a request. No new regulations have been issued to comply with the Securities Market Law in this regard; thus, it is difficult to estimate how long registration will take (under the Abrogated Law and the Authorization Regulations, it took many months). As stated above, there is a time limit (four months, which in exceptional cases may be extended only for two additional months), but this is not applied in practice by the Superintendence.

There has been no announcement regarding the regulations that need to be issued. In practice, the Superintendence's website list of brokers includes 239 individuals[62] and 44 corporations[63] (34 of which are allowed to participate in the Sicad II system). The Superintendence's Annual Report for 2013 has no record of new brokers being admitted, whereas it indicates that the inscriptions of nine brokers were cancelled.[64]

Securities

The definition of securities contained in the Securities Market Law is as follows:

> "It will be understood as securities, for the purposes of this law, the financial instruments which represent property or credit rights over the equity of a corporation, short, medium or long term, issued en masse, which have the same characteristics and grant their holders the same rights within their class. The National Superintendence of Securities, in cases of doubt, shall determine which are the securities regulated by this Law.
>
> ". . . derivative instruments, different types of instruments or securities representing a right of option for the purchase or sale of securities and futures contracts on securities, where the parties agree to buy or sell a given amount of securities at a predetermined price and date, and generally any other type of instrument whose value is determined and fixed by reference to the value of other assets or group of them.

59 Rules on Fees, art 1, para 2(3).
60 Rules on Fees, art 1(e).
61 Rules on Fees, art 1(d).
62 http://www.snv.gob.ve/snv/rnv/cptv.php.
63 http://www.snv.gob.ve/snv/rnv/consultaempresasjuridicas.php?tipo_empresa=2&tipo_empresa1=5.
64 http://www.snv.gob.ve/snv/documentos/ecofinmer/informes%20anuales/infoanual13.pdf.

> ". . . securities which represent property rights, warranties and other rights or contracts on agricultural products and supplies."[65]

The treatment of securities in the Securities Market Law differs from the same subject in the Abrogated Law. The latter also established a definition of the securities; however, the definition simply stated that "corporations' shares, obligations and any other securities issued en masse that have the same characteristics and grant their holders the same rights within their class" must be considered securities in accordance with such law.[66] The Abrogated Law then went on to regulate each of the most common securities, establishing their legal regime.

In the Securities Market Law, securities are only defined in general terms. There is no explicit mention of bonds, participation certificates, and commercial papers, and no specific provisions apply to them. The Securities Market Law simply states, in very general terms (when establishing the functions of the Superintendence and within the context of authorizing and registering the public offer of securities), that the Superintendence must issue rules regarding securities.[67]

Only with regard to bonds (*obligaciones*) has the Superintendence complied with its obligation to issue rules. In January 2011, the Superintendence issued the Rules Regarding the Public Offer and Placement of Securities and the Publicizing of Issues (*Normas Relativas a la Oferta Pública y Colocación de Valores y a la Publicación de las Emisiones,* the "Public Offer Rules"[68]). The Public Offer Rules contain a chapter dedicated to bonds.

The Securities Market Law does explicitly include derivatives in the definition of securities, and gives them the same treatment as the rights of option for purchase or sale of securities and future contracts of securities. It also explicitly includes securities that represent property rights, warranties, and other rights or contracts on agricultural products and supplies. Issuer requirements in order to make a public offer of securities are contained in the Public Offer Rules that were issued under the Securities Market Law.

Article 2 of the Public Offer Rules establishes as its first requirement that the issuer obtain from the Superintendence authorization to make a public offer. Article 4 provides that such authorization and the registration of the issue in the National Securities Registry are prerequisites for making a public offer of securities.

Periodic Disclosure

In General. Venezuelan capital markets regulations strictly establish the information that its actors must disclose periodically to the Superintendence.

65 Securities Market Law, art 16.
66 Abrogated Law, art 22.
67 Securities Market Law, art 8(2).
68 *Official Gazette* Number 39.585 of 3 January 2011.

Article 43 of the Securities Market Law establishes that corporations subject to it may notify the Superintendence in advance regarding the following:

- Variations of equity;
- Sale of the main asset;
- Change in the object of the company;
- Merger or transformation of the company; and
- Other actions which the Superintendence may establish.[69]

According to the Rules Regarding the Economic and Financial Information that must be supplied by persons subject to the Control of the National Superintendence of Securities (*Normas Relativas a la Información Económica y Financiera que deben suministrar las Personas sometidas al Control de la Superintendencia Nacional de Valores*, the "Economic and Financial Disclosure Rules"[70]), the actors regulated by the Superintendence are required to provide certain information periodically. The Economic and Financial Disclosure Rules establish the type of information required depending on the subject entity:

- Issuers;
- Collective investments entities and their administrating corporations;
- Brokers; and
- Transfer agents.

Issuers. In accordance with the Economic and Financial Disclosure Rules, within the seven days following the annual ordinary shareholders' meeting, such companies must deliver to the Superintendence the following documents:

- Approved financial statements;
- Internal auditor's report;
- Certified copy of minutes of the shareholders' meeting;
- Information regarding dividends and the remuneration of the board of directors;
- A report from the board of directors that includes the most important variations, new contracts, new activities, litigation, and any other important new fact that may affect the company;
- List of shareholders;
- Report regarding the compliance with the good corporate government principles established by the Superintendence;

69 Securities Market Law, art 43.
70 *Official Gazette* Number 39.547 of 15 December 2010.

- Report on the methods and procedures used to prevent money laundering; and
- Most recent income tax declaration.

In addition, every quarter, within 30 days after the accounting closing, issuers must provide the Superintendence with quarterly financial statements, explaining the most significant variations compared to the same quarter from the earlier year. Issuers also must publish monthly the following information:

- Financial statements, compared to the same month of the previous year and adjusted for inflation; and
- Solvency indicators, working capital indicators, long and short-term debt, and return over equity and return over assets.

Issuers also must inform the Superintendence of any economic or financial fact or legal action that may be important for the estimation of the prices or the circulation of the securities. They must also inform about declared dividends and any transactions between the companies and the board of directors or their principal shareholders, or with companies related to either. Issuers must provide notice, with 30 days' anticipation, of any shareholders' meeting to be convened to decide the dissolution of the company, the extension of its term, its merger to another company, the sale of its main asset, or the change of its object.

In the case of meetings to decide the increase or reduction of capital, the issuer must inform the Superintendence with 15 days' anticipation. Issuers who have been authorized by the Superintendence to issue securities through public offers abroad must provide to the Superintendence the information above, as well as any other information requested by the regulatory institution abroad.

Brokers

Brokers also must provide economic and financial information, periodically, to the Superintendence, in accordance with the Economic and Financial Disclosure Rules. Brokers must provide to the Superintendence, in the first five days of each quarter, operations of their own and related portfolio of the previous quarter, including a report on the date of the operation, the issuer of the securities, the type of operation, the conditions, and the quantity.

Annually, within 15 days from each year's closing, brokers must provide a report of the owners of the securities of the related portfolio. Subsequently, if there is any change, they must inform the Superintendence. Corporate brokers must provide the Superintendence, within the next 15 days after the last monthly closing, the following information:

- Financial statements prepared by a public accountant;
- Report of their own portfolio, mentioning issuers, description of the securities, date of acquisition, date of maturity, value, currency, and exchange rate;

- Report of the related portfolio organized by each of the holders of securities related to the broker, mentioning issuers, description of the securities, date of acquisition, date of maturity, value, currency, and exchange rate;
- Report of the administrated portfolio organized by the clients, mentioning each contract and including the securities included in the contract; and
- Report of the portfolio in custody.

The corporate brokers must celebrate the ordinary shareholders' meeting in 90 days following the annual closing. Within eight days following the shareholders' meeting, such companies must deliver to the Superintendence a certified copy of the minutes of the shareholders' meeting. In addition, the corporate brokers must within 30 days following the shareholders' meeting, deliver the registered certified copy of the minutes.

Within 15 days following the closing of each semester, companies must deliver to the Superintendence a report of the operations done during the last semester. Every quarter, within five days after the accounting closing, brokers must, provide to the Superintendence their portfolio operations and the related portfolio operations, mentioning the date, the issuer, type of operation, conditions, amount, price, and custody.

Within 90 days following the semester closing, corporate brokers must deliver to the Superintendence the approved financial statements, a report on the methods and procedures used to prevent money laundering, and the most recent income tax declaration. Corporate brokers must inform the Superintendence of any economic or financial fact or legal action that may affect them. Additionally, they give notice as to litigation, changes in their statutes, changes in bank loans situations, and changes in the board of directors or relevant personnel.

Other Participants

Members or shareholders of a stock exchange must, within 90 days following the semester closing, deliver to the Superintendence financial statements, a report of their operations, and most recent income tax declaration. Brokers who are not members or shareholders of a stock exchange must, within 30 days after the closing of the financial year, deliver to the Superintendence financial statements, a report of their operations, and most recent income tax declaration.

Other participants, such as transfer agents, must disclose information periodically to the Superintendence. Additionally, the Authorization Regulations, issued under the Abrogated Law, provided for the Commission, now the Superintendence, exercise control over investment advisers, such as by:

- Requiring that certain documents be kept by the Investment Adviser or submitted by the Investment Adviser to the Superintendence;[71]

71 "Documents" include correspondence, memoranda, books and other registries (of memoranda of instructions of received fees), invoices, and recommendations.

- Requiring that when the investment adviser renders advice in connection with related corporations, the adviser must previously notify the Superintendence, as well as its clients; and
- Requiring that marketing material related to investment advisory services be previously approved by the Superintendence.

Trading Rules

Securities Offerings

As stated above, the Public Offer Rules provide that the indispensable prerequisites needed in order to make a public offer of securities are the Superintendence's authorization to make a public offer and the registration of the issue in the National Securities Registry.

The primary placement can be done by the Issuer or by a placement agent (who must be a broker or have been expressly authorized as placement agent by special laws). The price of the offer must be mentioned in the prospectus and must be maintained during all the placement period.

The issuer must publish in a national journal and in a local journal a notice publicizing the issue, at least five days before the primary placement takes place. In the notice, the issuer must mention the names, addresses, email addresses, and telephone numbers of the placement agents. In addition, within five days after the end of the placement process, the issuer must publish a notice of the end of the process. The notices must be approved by the Superintendence. Once the primary placement ends, the issuer must deliver to the Superintendence the results, with the identification of buyers and the amount acquired.

Article 8 provides that the issuer must indicate the term during which the placement of the issue will take place. That term will begin at the time published in the public notice and may not exceed six months. The Public Offer Rules require that the issuer and the intermediaries who participate in the primary placement must give preference to small and medium investors to purchase the securities, during the first five days following publication, in accordance with the guidelines established by the Superintendence for each case. These features should be included in the prospectus and in any other publications.[72]

Issuers, placement agents, and distributors must follow the rules established in the prospectus and in the contract of primary placement (which must be approved by the Superintendence). Placement agents can celebrate distribution contracts with brokers or with distribution agents. Issuers, placement agents, and distributors must register operations daily, and the information contained in those registries must be delivered to the Superintendence monthly.

The prospectus must be authorized by the Superintendence. Once the securities are registered in the Superintendence, the issuer must provide the

72 Public Offer Rules, art 19.

Superintendence with the final prospectus in order to begin the public offer. The issuer also must deliver to the Superintendence the placement contracts, common representative contracts, payment agent contract, and custody contract, all notarized. Although the prospectus cannot circulate publicly before the issue is authorized, the issuer can privately deliver it to the agents of placement and distribution. All advertising related to the issue must be authorized by the Superintendence.

Disclosure of Acquisition of Substantial Holdings

Article 18 of the Securities Market Law regulates public take-over bids. Its sole paragraph provides the following with regard to "significant participations", as the law terms it:

> "The person who wishes to acquire in a single or by successive acts a volume of shares listed on a stock exchange that will lead to reaching a significant participation in the capital of a company, or to the ability to control administrative organs thereof, shall make public the information public in the media and within the periods that the National Superintendence of Securities shall determine in the rules that it will dictate to that effect.
>
> "The person who has not made the notifications referred to in this article may not be able to exercise the rights derived from the acquired securities and the agreements adopted with such person's participation shall be null and void without prejudice to the penalties provided in the Law."[73]

The Rules on Public Offers of Acquisition, Interchange, and Take-Over of Companies That Make Public Offer of Their Stock and Other Securities (*Normas sobre Ofertas Públicas de Adquisición, de Intercambio y Toma de Control de Sociedades que hacen Oferta Pública de Acciones y otros Derechos sobre las mismas,*[74] the "Take-Over Rules") were issued by the Commission in 2000, under the Abrogated Law, which had a similar article regarding public take-over bids. The Take-Over Rules include a definition of what is called a "participation [which is] reputed significant", as follows:

> "Any participation in the capital of the company which represents, directly or indirectly, by means of ownership, beneficial interest, control rights over the right to vote, business integration agreements or any other manner, which allows the Initiator to obtain control or to increase its participation in more than 10 per cent."

According to the Take-Over Rules, a person who is initiating a public offer bid may notify the Commission, now the Superintendence, within the procedure established for public offer bids (see text, below). In addition, the Abrogated Law established, under article 122, that persons who directly or indirectly, under

73 Securities Market Law, art 18.
74 *Official Gazette* Number 37.039 of 19 September 2000.

whatever title, reached ownership or beneficial rights over more than 10 per cent of any kind of shares of an issuer, needed to notify the Commission within two days from the transaction.

It also established that the administrators of an issuer had to notify the Commission of any acquisition of shares of such issuer made by such administrators, within two days.[75] The Rules Relating to the Transparency of the Capital Markets (*Normas Relativas a la Transparencia de los Mercados Capitales*, the "Transparency Rules"[76]), issued under the Abrogated Law, develop the provisions of article 122 of the Abrogated Law. The Securities Market Law has no equivalent provision but, since the regulations of the Transparency Rules do not contradict the Securities Market Law, they are applicable.

Privileged Information

Article 38 of the Securities Market Law defines privileged information as follows:

> "Privileged information is that information which is not accessible or available to the public, of a precise character, and which if made public, influences or may influence, in an appreciable manner, the trading of securities. It is not privileged information, that information which may be developed by third parties independently, or which is available to the public otherwise."[77]

The use of privileged information in the securities market in order to obtain an economic benefit is a criminal act, and article 52 of the Securities Market Law provides that it is punished by prison (three months to two years), fines, and disqualification. The Securities Market Law also states that the employees of the Superintendence should not divulge data or confidential or privileged information, under the penalties established above and dismissal.[78]

The wording of the Securities Market Law's definition of privileged information stresses that it influences or may influence trading in an appreciable manner. The law does not specify further. However, the Transparency Rules, which were issued under the Abrogated Law, explain that the terms that "may influence in an appreciative manner the trading of securities" are to be understood as referring to "any fact or event of any nature, such as legal or economic, financial, managerial, technological, natural events, which in the opinion of the issuing company affects or may affect it".[79]

Issuers are obliged to divulge privileged information in accordance with the provisions of the Securities Market Law[80] and the Transparency Rules. Issuers must prepare and deliver "immediately" to the Commission, now the

75 Abrogated Law, art 122.
76 *Official Gazette* Number 36.650 of 6 February 1999.
77 Securities Market Law, art 38.
78 Securities Market Law, art 11.
79 Transparency Rules art 1.
80 Securities Market Law, art 38.

Superintendence, a report with a succinct summary of the information, including economic, financial, and other details which are "indispensable" for the market to reach a reasonable criterion about the facts, events, or situation provided.[81] Such report must then be delivered "immediately" to at least three national or international news agencies (which provide national coverage), one of which must provide "real time" information.[82]

According to the Abrogated Law, if the issuer considered that the immediate disclosure of the information could be damaging to its legitimate interests or to the interests of the holders of securities issued by the issuer, it should provide the information to the Commission, requesting that the matter remain confidential. If the Commission did not answer within two days, the issuer had to make the information public. This provision was further developed in article 20 of the Transparency Rules, which indicated that it must be a reasoned request which must explain with clarity the motivations of fact or law. The Securities Market Law contains no equivalent provision.

Public Take-Over Bids

In 2000, under the Abrogated Law, the Commission issued the Take-Over Rules. Article 109 of the Abrogated Law stated that the Commission, now the Superintendence, should issue the rules governing the procedure of public take-over bids. The Securities Market Law also contains a similar provision, so the Take-Over Rules continue to apply. The aim sought by the Take-Over Rules, as established in article 2, is to:

- Provide a transparent procedure, in order to prevent erratic fluctuations and deviations in the value of shares and other securities;
- Allow the orderly participation, in conditions of equality, of all shareholders;
- Permit bids by other interested parties, who may wish to equal or improve the offers' conditions; and
- Promote the supply of the information required by the existing shareholders, regarding their decision on whether or not to sell.

The Take-Over Rules cover public offers of acquisition (*Ofertas Públicas de Adquisición*, OPA), exchange public offers (*Ofertas Públicas de Intercambio*, OPI), and public take-over offers (*Ofertas Públicas de Toma de Control*, OPTC).

In the first two cases, the initiator of the offer does not have and seeks to own a "significant participation" (to obtain control or to increase its participation in more than 10 per cent of the capital) with the proviso that the procedure "does not have the effects of a takeover". The difference between OPA (acquisition) and OPI (exchange) regards compensation. In the first case, it is the payment of money; in the second, it is the transfer of securities.

81 Transparency Rules, arts 2 and 3.
82 Transparency Rules, art 4.

A take-over offer (OPTC) is the procedure whereby the initiator seeks to acquire or to complete (by the transfer of money and/or securities) a controlling majority, or to increase its existing share participation by a percentage equivalent to a significant participation. The Take-Over Rules also apply to shareholders who wish to increase their participation by more than 10 per cent or by any percentage, if in a takeover situation, and majority shareholders who wish to increase their participation.

Regarding sellers, the Take-Over Rules apply also to shareholders who offer publicly to sell to the best bidder a significant participation or the majority control (more than 50 per cent or the effective control of the decisions of the shareholders' meeting). The Take-Over Rules establish the common procedure to be complied with, briefly summarized as follows:

- The initiator must file a report before the Superintendence, stating the information relevant to the offer. The duration of the offer must be set by the initiator, within a limit of no less than 20 and no more than 30 stock market working days;
- The Superintendence will then accept or deny the authorization for the release of the report;
- The target company must then consign its observations, including a report from its board of directors, with these observations released to the public, after notifying the Superintendence;
- Any person, including the shareholders of the company involved, may present a competing offer, thus becoming an initiator;
- Initial offers may be modified, subject to the Superintendence's approval of the release of the modified report;
- Offers may be revoked simply by previously notifying the Superintendence provided the revocation is made before the offer becomes effective, with the Superintendence having to approve revocation if made afterwards;
- Acceptance of the offer must be notified to its initiator;[83] and
- The payment due must be made in a stock exchange within five stock market working days following the closing of the offer.

Additionally, certain formalities apply to each of the different types of public offer, such as, in case of take-overs, the filing of a special report with detailed information (including future plans). There also is a simplified procedure that applies if the initiator already owns at least two-thirds of the shares and offers to acquire total control of the company, the offer is limited to 10 per cent of the shares, and the company concerned proceeds to a plan of acquisition of treasury shares.

83 The acceptance also may be revoked, but only in certain cases.

European Union

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European Union

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Introduction

The realisation of a Common Market requires as one prerequisite a unified capital market. Harmonised rules for the handling and trading of securities have been identified as an important step towards a common European capital market. The European Union (EU) has issued a set of Directives to accomplish that goal. Particularly the following Directives, partly amended through subsequent Directives, are to be mentioned:

- Council Directive 79/279/EEC of 5 March 1979, co-ordinating the conditions for the admission of securities to official stock exchange listing;
- Council Directive 80/390/EEC of 17 March 1980, co-ordinating the requirements for the drawing up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing;
- Council Directive 85/611/EEC of 20 December 1985, on the co-ordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS);
- Council Directive 82/121/EEC of 15 February 1982, on the information to be published on a regular basis by companies the shares of which have been admitted to official stock exchange listing;
- Council Directive 88/627/EEC of 12 December 1988, on the information to be published when a major holding in a listed company is acquired or disposed of;
- Council Directive 89/298/EEC of 17 April 1989, co-ordinating the requirements for the drawing-up, scrutiny, and distribution of the prospectus to be published and transferable securities offered to the public;
- Council Directive 89/592 EEC of 13 November 1989, co-ordinating regulations on insider dealing; and
- Council Directive 93/22/EEC of 10 May 1993, on investment services in the securities field.

Conditions for Admission of Securities to Listing

In General

As a first step, the European Council introduced Directive 79/279/EEC of 5 March 1979, relating to the conditions for admission to official stock exchange listing. Admission to

official listing on stock exchanges of EU member states of securities issued by undertakings had been realised to constitute an important means of access to the capital markets; however, safeguards for the protection of the interests of actual and potential investors were identified as indispensable.[1]

Equivalent protection for investors, facilitated admission to official stock exchange listing for securities from other member states, and multiple listing of such securities on a number of stock exchanges within the EU were declared in the preamble. Legal harmonisation was expected to further the development of a European capital market. In 1979, co-ordination was meant to be only temporarily limited to the establishment of minimum conditions; further harmonisation measures were planned to follow. Neither this Directive nor others issued in this field by the Council or the Commission contain a definition of 'securities' or of 'stock exchanges'.

Applicability of Directive 79/279/EEC

Directive 79/279/EEC applies to securities which are admitted to official listing or which are subject of an application for such admission on a stock exchange in a member state,[2] regardless of the legal status of their issuers, and also applies to non-EU states or their regional or local authorities or international public bodies. At a member state's option, the Directive does not apply[3] to:

- Securities issued by an EU member state or its regional or local authorities; and
- Units issued by collective investment undertakings other than the closed-end type.[4]

Conditions for Admission to Official Listing

In General

Directive 79/279/EEC introduces conditions for admission of securities to official listing in two schedules, namely Schedule A for shares and Schedule B for debt securities.

Schedule A – Conditions for Shares

The company which seeks admission of its shares to official listing must fulfil, among others, the following requirements:

1 European Community Directive 80/390/EEC.
2 Directive 79/279/EEC, art 1, para 1.
3 European Community Directive 79/279/EEC, art 1, para 2.
4 Such units are defined in article 2 of Directive 79/279/EEC as unit trusts and investment companies, the object of which is collective investment of capital provided by the public and which operate on the principle of risk spreading, and the units of which are, at the request of holders, repurchased or redeemed out of the assets of these undertakings. As an alternative to repurchase or redemption, the undertaking could ensure that the stock exchange value of its units does not significantly vary from their net asset value.

- Its legal position as regards both formation and operation must be in conformity with the applicable laws and regulations;
- In general, the foreseeable market capitalisation, respectively capital and reserves, must be at least €1 million; and
- With certain exceptions, the company must have published or filed its annual accounts for the three financial years preceding the application.

The legal position of the shares concerned must be in conformity with the applicable laws and regulations. The shares must be freely negotiable. If shares have been publicly issued before admission to official listing, such listing may be made only when the subscription period has ended. As a further prerequisite for a listing, a 'sufficient' number of shares must be distributed to the public.[5]

An admission for official listing must cover all shares of a certain class, except blocks serving to maintain control or shares not negotiable for a certain term under agreements, provided the public is informed and there is no danger for the interests of the holders. The shares must comply (only) with the physical form requirements for shares in the member state of which the issuer is a national. If shares issued by a national of a non-EU state are not listed, either in the country of origin or in the country in which the major proportion of the shares is held, a listing may be granted only if this is not the case for reasons of investor protection.

Schedule B – Conditions for Debt Securities

Debt Securities Issued by Undertakings. In regard to debt securities issued by an undertaking, the issuing undertaking's legal position must be in conformity with the laws and regulations to which it is subject, as regards both its formation and operation. The legal position of the debt securities must be in conformity with the laws and regulations to which they are subject; they must be freely negotiable.

Except in case of tap issues, if debt securities have been publicly issued before admission to official listing, such listing may be made only when the subscription period has ended. All debt securities ranking *pari passu* must be covered by the application. The debt securities must comply (only) with the physical form requirements for such securities in the member state of which the issuer is a national; the physical form of debt securities issued in a single member state must conform to the standards in force in that member state. The physical form of debt securities issued by a national of a non-EU state must afford sufficient safeguard for investor protection.

Except in case of tap issues, where the amount is not fixed, the amount of the loan must be at least €200,000, unless the competent authority rules that there will be a sufficient market for the debt securities even though the minimum amount of €200,000 is not reached.

5 In general, a 'sufficient number' is 25 per cent of the subscribed capital represented by the class of the shares concerned.

Convertible or exchangeable debentures and debentures with warrants may be admitted to official listing only if the related shares are already or simultaneously listed on the same stock exchange or on another regulated, regularly operating, recognised open market, unless an EU member state provides for admission to official listing on the basis of a decision by the competent authority that the holders have at their disposal all the information necessary to form an opinion concerning the value of the shares to which these debentures relate.

Debt Securities Issued by State, Regional, or Local Authorities, or Public International Body. In regard to debt securities issued by a state, regional, or local authority, or a public international body, the debt securities must be freely negotiable. Except where the closing date for subscription is not fixed, in case of a public issue preceding admission to official listing, the first listing may be made only after the end of the period during which subscription applications may be submitted.

All debt securities ranking *pari passu* must be covered by the application. The debt securities must comply (only) with the physical form requirements in the member state in which they are issued; the physical form of debt securities issued by non-EU states or their regional or local authorities or by public international bodies must afford sufficient safeguard for investor protection.

Schedules C and D

In General. The obligations to be met by issuers of securities admitted to official listing are set out in Schedule C (relating to shares) and Schedule D (relating to debt securities).

Schedule C – Obligations of Companies Whose Shares Are Admitted to Official Listing. If issued shares of the same class as already listed shares are not automatically admitted, the company will be required to apply for their admission to the same listing, either not more than a year after their issue or when they become freely negotiable.

The company must ensure equal treatment for all shareholders in the same position. The company must ensure, at least in each member state in which its shares are listed, that all the necessary facilities and information are available to enable shareholders to exercise their rights. It must inform the shareholders of the holding of meetings and enable them to exercise their right to vote, publish notices or distribute circulars concerning the allocation and payment of dividends and the issue of new shares including allotment, subscription, renunciation, and conversion arrangements and, unless the company itself provides financial services, designate as its agent a financial institution through which shareholders may exercise their financial rights.

A company planning an amendment to its instrument of incorporation or its statute must communicate a draft thereof to the competent authorities of the member states in which its shares are listed not later than the calling of the general meeting to decide on the proposed amendment.

The company must make available to the public, as soon as possible, its most recent annual accounts and its last annual report. If the company prepares both annual own and annual consolidated accounts, the competent authorities may authorise the company to make available either only their own or the consolidated accounts, provided the accounts not made available do not contain any significant additional information. More detailed, respectively additional, information must be published, if the annual accounts and reports do not comply with the provisions of Council Directives and if they do not give a true and fair view of the company's assets and liabilities, financial position, and profit or loss.

The company must inform the public as soon as possible in respect of any major new developments in its sphere of activity which are not public knowledge and which, by virtue of their effect on its assets and liabilities or financial position or on the general course of its business, may lead to substantial movements in the prices of its shares. The competent authorities, however, may exempt the company from this requirement if the disclosure of particular information is such as to prejudice the legitimate interests of the company.

The company must inform the public of any changes in the rights attaching to the various classes of shares and of any changes in the structure (shareholders and breakdown of holdings) of the major holdings in its capital as compared with information previously published on that subject.[6] A company which is not subject to Directive 88/627/EEC must inform the public within nine days when it comes to its notice that a person or entity has acquired or disposed of a number of shares such that his or its holding exceeds or falls below one of the thresholds laid down in article 4 of Directive 88/627/EEC.

A company whose shares are officially listed on stock exchanges situated or operating in different member states must ensure that equivalent information is made available to the market at each of these exchanges. If shares are listed in non-EU states as well, the company must make available equivalent information in the member states where the shares are officially listed, if such information may be of importance for the evaluation of the shares.

Schedule D. In respect of debt securities issued by an undertaking, the undertaking must ensure equal treatment for all holders of debt securities ranking *pari passu*. However, in accordance with national law, offers of early repayment of certain debt securities may be made in derogation from the conditions of issue and in particular in accordance with social priorities.

The undertaking must ensure that at least in each member state where its debt securities are officially listed all the facilities and information necessary to enable holders to exercise their rights are available; in particular, it must publish notices or distribute circulars concerning the holding of meetings of holders of debt securities, the payment of interest, the exercise of any conversion, exchange, subscription or renunciation rights, and

6 European Community Directive 88/627/EEC of 12 December 1988, on the information to be published when a major holding in a listed company is acquired or disposed of.

repayment and, unless itself provides financial services, must designate as its agent a financial institution through which holders of debt securities may exercise their financial rights.

An undertaking planning an amendment to its instrument of incorporation or its statutes affecting the rights of holders of debt securities must forward a draft thereof to the competent authorities of the member states in which its debt securities are listed no later than the calling of the meeting of the body which is to decide on the proposed amendment.

The undertaking must make available to the public as soon as possible its most recent annual accounts and its last annual report, the publication of which is required by national law. The competent authority may authorise the undertaking to make available either only their own or the consolidated accounts, provided the accounts not made available do not contain any significant additional information.

More detailed additional information must be published if the annual accounts and reports do not comply with the provisions of Council Directives and if they do not give a true and fair view of the undertaking's assets and liabilities, financial position, and profit or loss. The undertaking must inform the public as soon as possible of any major new developments in its sphere of activity which are not public knowledge and which may significantly affect the undertaking's ability to meet its commitments. The competent authorities, however, may exempt the undertaking from this requirement, if the disclosure of particular information would be such as to prejudice the legitimate interests of the undertaking. The undertaking must inform the public without delay of new loan issues and in particular of any guarantee or security in respect thereof. In the case of officially listed convertible or exchangeable debentures or debentures with warrants, the undertaking must inform the public without delay of any changes in the rights attaching to the various classes of shares to which they relate.

An undertaking, the debt securities of which are officially listed on stock exchanges situated or operating in different member states, must ensure that equivalent information is made available to the market at each of these exchanges. If debt securities are listed in non-EU states as well, the undertaking must also make available equivalent information in the member states where the shares are officially listed, if such information may be of importance for the evaluation of the debt securities.

In respect of debt securities issued by a state or its regional or local authorities or by a public international body, issuers must ensure that all holders of debt securities ranking *pari passu* are given equal treatment in respect of all the rights attaching to those debt securities. However, early repayment offers may be made in accordance with national law (see text, above). The issuers must ensure the facilities and information necessary to enable holders of debt securities to exercise their rights are available (see text, above).

Subject to the prohibitions provided in Schedules A and B, EU member states are free to introduce more stringent rules for the admission of securities to official listing, provided that such rules apply generally for all issuers or for individual classes of issuer and that they have been published before application for admission of such securities. However, member states may not require as a prerequisite for admission to official listing that such security has been already admitted to official listing on another stock exchange within the EU.

Member states may make the issuers of securities admitted to official listing subject to more stringent rules than those set out in Schedules C and D, provided that these rules apply generally for all issuers or for individual classes of issuer. They may authorise derogations from such more stringent conditions, but any derogations from the conditions to be authorised in accordance with Schedules A and B must apply generally to all issuers where the circumstances justifying them are similar.[7] Member states may require issuers of securities admitted to official listing to inform the public on a regular basis of their financial position and the general course of their business.[8]

The member states must establish authorities competent to decide on the admission of securities to official listing and must inform the European Commission about allocation of duties. Such competent authorities may reject an application for the admission to official listing if, in their opinion, such admission would be detrimental to investors' interests.[9] Solely in the interests of protecting the investors, if thereto authorised by the member state, the competent authorities may subject the admission to any special condition which the competent authorities consider appropriate and of which they have explicitly informed the applicant.[10] The competent authorities may refuse to admit to official listing a security already officially listed in another member state where the issuer fails to comply with the obligations resulting from admission in that member state.[11]

An issuer's failure to comply with the obligations resulting from admission to official listing may be published.[12] The issuer must provide the authorities with all information appropriate in the authorities' opinion to protect investors or ensure the smooth operation of the market.[13]

The authorities may prescribe the publication of information in a form and within time limits appropriate for the protection of investors or smooth operation of the market.[14] The authorities also are authorised to suspend the listing of a security if one of these two objectives is impaired or if they conclude that normal regular dealings in a security are no longer possible.[15]

Decisions refusing the admission of a security to official listing or discontinuing such a listing will be subjected to appeal to the courts.[16] The authority must decide about an application for admission to official listing within six months from the time when an application containing all the relevant information has been filed.[17] If, within six months, no decision has been rendered, this will be deemed a rejection of the application, subject to appeal to court.[18]

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7 European Community Directive 79/279/EEC, art 5, paras 6 and 7.
8 European Community Directive 79/279/EEC, art 5, para 4.
9 European Community Directive 79/279/EEC, art 9, para 3.
10 European Community Directive 79/279/EEC, art 10.
11 European Community Directive 79/279/EEC, art 11.
12 European Community Directive 79/279/EEC, art 12.
13 European Community Directive 79/279/EEC, art 13, para 1.
14 European Community Directive 79/279/EEC, art 13, para 2.
15 European Community Directive 79/279/EEC, art 14.
16 European Community Directive 79/279/EEC, art 15, para 1.
17 European Community Directive 79/279/EEC, art 15, para 2.
18 European Community Directive 79/279/EEC, art 15, para 3.

The issuer of the certificates representing shares must offer adequate safeguards for the protection of investors.[19] Information to be provided by the issuers is listed in Schedules C and D, to be published in one or more newspapers generally in the official language of the country.[20]

If an application is made for a security already listed on a stock exchange in another EU member state, the authorities must communicate to expedite and simplify the procedure as far as possible. The application must state whether a similar application is being made or has been made or will be made in another member state.[21] A Contact Committee must deliver opinions relating to measures concerning the implementation.[22]

The Council Directive of 3 March 1982 (amending Directive 79/279/EEC, co-ordinating the conditions for the admission of securities to official stock exchange listing, and Directive 80/390/EEC co-ordinating the requirements for the drawing up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing) only extended the implementation period for national legislation.

Rules Relating to Listing Particulars

In General

The legal basis for listing particulars is Directive 80/390/EEC.[23] The provision of information is required for the protection of the interests of actual and potential investors. Such information must be sufficient and as objective as possible concerning the financial circumstances of the issuer and particulars of the securities.

Differences in the safeguards between member states, both as regards the contents and the layout of the listing particulars and the handling of such information, made it difficult for undertakings to obtain admission of securities to official listing on stock exchanges of several member states and hindered acquisition by investors residing in other member states. The financing of the undertakings and investment throughout the EU was impaired.

As a system of surveillance did not exist in all member states for securities offerings, the first co-ordination efforts were made concerning the admission of securities to official stock exchange listing. By co-ordinating rules and regulations, Directive 80/390/EEC aims at achieving an adequate degree of equivalence in the safeguards to ensure provision of information is as sufficient and as objective as possible.

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19 European Community Directive 79/279/EEC, art 16.
20 European Community Directive 79/279/EEC, art 17.
21 European Community Directive 79/279/EEC, art 18, para 3.
22 European Community Directive 79/279/EEC, art 20.
23 European Community Directive 80/390/EEC of 17 March 1980, co-ordinating the requirements for the drawing up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing.

Applicability of Directive 80/390/EEC

In General

Directive 80/390/EEC does not apply to units issued by collective investment undertakings, other than the closed-end type and to securities issued by a state or by its regional or local authorities. Publication of an information sheet ('listing particulars') was fixed as conditional for the admission of securities to official listing on a stock exchange situated or operating within the EU.[24]

The listing particulars must contain the information which is necessary to enable investors and their investment advisers to make an informed assessment of the assets and liabilities, financial position, profit and loss, and prospects of the issuer and of the rights attaching to such securities.[25] The Annex to Directive 80/390/EEC contains Schedules A, B, and C, relating to minimum standards of information.

Schedule A

Schedule A relates to shares. Chapter 1 requires information concerning the persons responsible for the listing particulars and the auditing of accounts and the declaration by those persons that, to the best of their knowledge, the information given in that part of the listing particulars for which they are responsible is in accordance with the facts and contains no omissions likely to affect the declaration of the listing particulars, and of the auditors who have audited the company's annual accounts for the preceding three financial years.

Chapter 2 requires information concerning admission to official listing and information concerning the shares for the admission of which the application is made. Chapter 3 requires general information about the issuer and its capital.

Chapter 4 requires information concerning the issuer's activities. Chapter 5 requires information concerning the issuer's assets and liabilities, financial position, and profit and loss. Chapter 6 requires information concerning administration, management, and supervision. Chapter 7 requires information concerning the recent development and prospects of the issuer.

Schedule B

Schedule B lays out listing particulars for debt securities. Chapter 1 requires information concerning those responsible for listing particulars and the auditing of accounts. Chapter 2 requires information concerning loans and the admission of debt securities to official listing.

24 European Community Directive 80/390/EEC, art 3.
25 European Community Directive 80/390/EEC, art 4.

Schedule C

Schedule C concerns listing particulars for certificates representing shares and its chapter 1 requires general information about the issuer; chapter 2 requires information on the certificates.[26] Partial or complete exemption from the obligation to publish listing particulars as a prerequisite for the admission to official listing may be granted in the following cases:

- For securities having been the subject of a public issue or having been issued in connection with a take-over offer or in connection with a merger involving the acquisition of another company or the formation of a new company, the division of a company, the transfer of all or part of an undertaking's assets and liabilities, or as consideration for the transfer of assets other than cash, provided that within 12 months before the admission to official listing, a document, regarded by the competent authorities as containing information equivalent to that of the listing particulars provided for by Directive 80/390/EEC, has been published in the same member state;[27]
- Shares (a) allotted free of charge to holders of shares already listed on the same stock exchange, (b) resulting from the conversion of convertible debt securities or created after an exchange for exchangeable debt securities, if shares of the same company are already listed on the same stock exchange, (c) resulting from the exercise of the rights conferred by warrants, if shares of such a company are already listed on the same stock exchange, or (d) issued in substitution for shares already listed on the same stock exchange if no increase in the company's issued share capital follows from such transaction;
- Shares amounting to less than 10 per cent of the number or of the value of shares of the same class already listed on the same stock exchange;
- Debt securities issued by companies and other legal persons which are nationals of this member state and which benefit from state monopolies and are governed by a special law or whose borrowings are unconditionally and irrevocably guaranteed by a member state or one of such member state's federated states;
- Certain debt securities issued by legal persons, other than companies, which are nationals of a member state and whose activities consist solely in raising funds under state control through the issue of debt securities and financing production by means of the resources which they have raised and resources provided by a member state, and the debt securities of which are considered as debt securities issued or guaranteed by the state;
- Shares allotted to employees, if shares of the same class have already been admitted to official listing on the same stock exchange;
- Securities already admitted to official listing on another stock exchange in the same member state;

26 European Community Directive 80/390/EEC, art 6.

27 In such a case, particulars of any material changes which have occurred meanwhile must be made available to the public as well. The document must be made available to the public at the registered office of the issuer and at the offices of the financial organisations retained to act as paying agents.

- Shares issued in consideration for the partial or total renunciation by the management of a limited partnership with a share capital of its statutory rights over the profits, if shares of the same class have already been admitted to official listing on the same stock exchange; and
- Supplementary certificates representing shares, provided no increase in the company's issued capital is involved and such certificates are already listed on the same exchange.[28]

Omission from the listing particulars of certain information provided for by the Directive may be granted by the competent authorities if such information is of minor importance only and will not influence assessment of the assets and liabilities, financial position, profit and loss, and prospects of the issuer; or disclosure of such information would be contrary to the public interest or seriously detrimental to the issuer, provided that, in the latter case, such omission would not be likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the securities in question.[29]

For securities offered on a pre-emptive basis to shareholders of the issuer whose shares are already listed on the same stock exchange, the competent authorities may limit the information to be provided.[30] Such listing particulars[31] must be accompanied by the annual accounts for the latest financial year.[32] If the issuer prepares both own and consolidated annual accounts, both sets of accounts must be enclosed. The authorities may grant an exemption if no material additional information is concerned. Limited information may be prescribed by the competent authorities for 'pure' debt securities.[33] The information to be provided also may be limited for debt securities normally bought and traded in by a limited number of sophisticated investors (investors particularly knowledgeable in investment matters).[34]

Regarding securities issued by financial institutions (which term for purposes of the Directive must be determined by the member states), the listing particulars must contain at least the information specified in chapters 1, 2, 3, 5, and 6 of Schedules A and B, respectively and, in addition, information adapted of the particular nature of the issuer and at least equivalent to that specified in chapters 4 and 7 of Schedules A and B, respectively.[35] Such rules may be extended[36] to:

- Collective investment undertakings not falling under the exemption of Directive 80/390/EEC, article 1, paragraph 2;

28 European Community Directive 80/390/EEC, art 6.
29 European Community Directive 80/390/EEC, art 7.
30 European Community Directive 80/390/EEC, art 8, paras 1 and 2.
31 European Community Directive 80/390/EEC, art 20.
32 European Community Directive 80/390/EEC, art 8, para3.
33 European Community Directive 80/390/EEC, art 9, para 1.
34 European Community Directive 80/390/EEC, art 10.
35 European Community Directive 80/390/EEC, art 11.
36 European Community Directive 80/390/EEC, art 11, para 3.

- Finance companies engaging exclusively in the raising of capital to make it available to their parent company or affiliates; and
- Licences or patents portfolio holding companies.

With regard to debt securities issued in a continuous or repeated manner by credit institutions which regularly publish their annual accounts and which, within the EU, are set up or governed by a special law or pursuant to such a law or are subject to public supervision designed to protect savings, the listing particulars may continue only limited information, particularly information concerning any events of importance having occurred since the end of the financial year in respect of which the last annual accounts were published.[37]

In case debt securities are guaranteed by a legal person, listing particulars must contain specific information regarding the issuers and the guarantor.[38] If convertible debt securities, exchangeable debt securities, or debt securities with warrants are concerned, the listing particulars must include information regarding to the shares and the conditions of and procedures for conversion, exchange or subscription and details of the situations in which they may be amended.[39]

The document describing the terms and conditions of a merger involving the acquisition of another company or the formation of a new company, the division of a company, the transfer of all or part of an undertaking's assets and liabilities, a take-over offer, or as consideration for the transfer of assets other than cash must be made available for inspection.[40] When the application for admission to official listing relates to certificates representing shares, the listing particulars must contain the information, as regards the shares represented, provided for in Schedule A.

The authorities may relieve the issuer of the certificates representing shares to publish details of its own financial position when the issuer is a credit institution which is a national of a member state and is set up or governed by a special law or pursuant to such law or is subject to public supervision designed to protect sources or is an at least 95 per cent-owned subsidiary of such credit institution, the commitments of which towards the holders of certificates are unconditionally guaranteed by that credit institution and are subject to the same public supervision.[41]

In regard to debt securities where repayment of the loan and the payment of interest is unconditionally and irrevocably guaranteed by a state or one of a state's federated states, the information to be provided may be limited. This also applies to specific companies.[42] Listing particulars must be approved by the competent authorities before they are published. One or more competent authorities are appointed by the member state and notified to the Commission. Liability of such competent authorities is governed solely by national law.[43]

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37 European Community Directive 80/390/EEC, art 12.
38 European Community Directive 80/390/EEC, art 13.
39 European Community Directive 80/390/EEC, art 14.
40 European Community Directive 80/390/EEC, art 15.
41 European Community Directive 80/390/EEC, art 16.
42 European Community Directive 80/390/EEC, art 17.
43 European Community Directive 80/390/EEC, art 18.

Listing particulars may be published either by insertion in newspapers or in the form of a brochure to be made available, free of charge, at the concerned stock exchange, at the registered office of the issuer and at the offices of the paying agents. In addition, the listing particulars or a notice about publication of the listing particulars must be inserted in a publication designated by the member state in which the admission to official listing is sought.[44]

National legislation must provide for a reasonable period for the publication of the listing particulars before the date on which official listing becomes effective. Where the admission is preceded by trading of the pre-emptive subscription rights giving rise to dealings recorded in the official list, the listing particulars must be published within a reasonable period before such trading starts, such period to be determined by the competent authorities.[45]

Under specific circumstances, the authorities may postpone publication of the listing particulars until after the date on which the official listing becomes effective if securities of a class already listed on the same stock exchange issued in consideration of transfers of assets other than cash are concerned or after the date of the opening of trading in pre-emptive subscription rights.

Every significant new factor capable of affecting assessment of the securities which arises between the time when the listing particulars are adopted and the time when stock exchange dealings begin must be covered by a supplement to the listing particulars, scrutinised in the same way as the latter and published in accordance with procedures to be laid down by the competent authorities.[46]

Applications for admission at various stock exchanges will be co-ordinated to the maximum extent possible if an application for admission to official listing is made within six months from previous listing in another member state and if the issuer may be exempted from the preparation of new listing particulars. However, there may be a need for updating or translation or the issue of supplements in accordance with the individual requirements of the member state concerned.[47]

Once approved in accordance with article 24 of Directive 80/390/EEC, listing particulars must be recognised by the other member states. It was realised that co-operation of the competent authorities did not result in a full mutual recognition of listing particulars. If, within a short interval, applications for admission to official listing have been filed in a number of countries, the member state in which the issuer's registered office is situated should take the lead. The listing particulars must be drawn up and approved under this member state's legislation, and the authorities of other member states may require only specific information relating to the income tax system, the financial organisations retained to act as paying agents in that country, the way in which notices to investors are published, and further information specific to that market.

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44 European Community Directive 80/390/EEC, art 20.
45 European Community Directive 80/390/EEC, art 21.
46 European Community Directive 80/390/EEC, art 23.
47 European Community Directive 80/390/EEC, art 24.

Rules Relating to Prospectus When Transferable Securities Are Offered

In General

In respect of the prospectus to be published when transferable securities are offered, the legal basis is the Council Directive of 17 April 1989, co-ordinating the requirements for the drawing-up, scrutiny, and distribution of the prospectus to be published and transferable securities offered to the public.[48]

To provide the information the investor needs to make an informed assessment of securities offered, only securities admitted to official stock exchange listing were governed by Directive 80/390/EEC. The idea of Directive 89/298/EEC is to require reasonable information but not to burden small and medium-sized issuers unduly. The Directive also is driven by the idea to establish a comparable basis for mutual recognition as laid down in Directive 80/390/EEC for securities to be admitted for official listing.

Applicability of Directive 89/298/EEC

Directive 89/298/EEC includes transferable securities issued by companies or firms governed by the laws of third countries. Prospectuses from third countries will be recognised on a reciprocal basis. The Directive is aimed at transferable securities offered to the public for the first time in an EU member state, but excluding securities listed on a stock exchange situated or operating in that member state.

The Directive does not cover the offer of securities to persons in the context of their trades, professions, or occupations or to a restricted circle of persons or for a selling price as a whole of not more than €40,000 or where the consideration is at least €40,000 per investor.[49] The Directive does not apply to:

- Transferable securities offered in individual denominations of at least €40,000;
- Units issued by collective investment undertakings other than of the closed-end type;
- Transferable securities issued by a state or a regional or local authority or by a public international body of which one or more member states are members;
- Transferable securities offered in connection with a take-over bid or merger;
- Shares allotted free of charge to holders of shares as well as shares or transferable securities equivalent to shares offered in exchange for shares in the same company if no increase in the company's issued share capital follows from such transaction;
- Transferable securities offered for the benefit of present or former employees;
- Transferable securities resulting from conversion or to shares offered in exchange for exchangeable debt securities if the public offer prospectus or listing particulars relating to those convertible or exchangeable securities were published in the same member state;

48 European Community Directive 89/298/EEC of 17 April 1989.
49 European Community Directive 89/298/EEC, art 2, para 1.

- Transferable securities issued, with a view to their obtaining the means necessary to achieve their disinterested objectives, by recognised non-profit associations;
- Shares or transferable securities equivalent to shares, ownership of which entitles the holder to avail himself of the services rendered by bodies, such as building societies, *crédits populaires*, *genossenschaftsbanken*, or industrial and provident societies, or to become a member of such a body; and
- Euro-securities which are not the subject of a generalised campaign of advertising or canvassing.

Any offer of transferable securities to the public falling under the Directive is subject to the publication of a prospectus by the person making the offer.[50] A partial or complete exemption may be granted for debt securities or other equivalent transferable securities issued in a continuous or repeated manner by credit institutions or other equivalent financial institutions which regularly publish their annual accounts and which are governed by a special legal status or are subject to public supervision intended to protect savings.[51]

If a full prospectus has been published, within 12 months, the same issuer in the same member state relating to different transferable securities may indicate only changes likely to influence the value of the securities. However, such prospectus may be made available only accompanied by the full prospectus or by a reference thereto.[52]

Directive 89/298/EEC contains provisions relating to the scrutiny and distribution of the prospectus for transferable securities for which admission to official stock exchange listing is sought. In general, Directive 89/298/EEC refers to Directive 80/390/EEC regarding public offers of securities for which, at the same time, admission to official listing is applied for.[53]

A similar rule applies in cases where a public offer is made in one member state and admission to official listing is sought in another member state, provided the member state where the public offer is made in general provides for prior scrutiny of public offer prospectuses.[54]

The prospectus must be published or made available to the public not later than the time when an offer is made to the public.[55] Directive 89/298/EEC also contains provisions for the prospectus for securities for which admission to official listing is not sought. Such prospectus must contain information to enable the investors to make an informed assessment of the assets and liabilities, financial position, profit and loss and prospects of the issuer, and of the rights attaching to such securities.[56] The prospectus must contain, in a form easily analysable and comprehensible, at least the following information relating to:

- Those responsible for the prospectus;
- The offer to the public and the transferable securities being offered;

50 European Community Directive 89/298/EEC, art 4.
51 European Community Directive 89/298/EEC, art 5.
52 European Community Directive 89/298/EEC, art 6.
53 European Community Directive 89/298/EEC, art 7.
54 European Community Directive 89/298/EEC, art 8.
55 European Community Directive 89/298/EEC, art 9.
56 European Community Directive 89/298/EEC, art 11, para 1.

- The issuer;
- The issuer's principal activities;
- The issuer's assets and liabilities, financial position, and profit and loss;
- The issuer's administration, management, and supervision; and
- Recent developments in its business and prospects, to the extent that such information would have a significant impact on any assessment that might be made of the issuer.[57]

For an offer relating to debt securities guaranteed by one or more legal persons, information also must be given regarding the guarantor(s).

In the case of convertible debt securities, exchangeable debt securities, or debt securities with warrants, information must also be given with regard to the nature of the shares or debt securities to which they confer entitlement and the conditions of and procedures for conversion, exchange, or subscription, and to an issuer of the shares if he is not the same as the issuer of the debt securities.

Where a class of shares has been admitted to dealing on a stock exchange market, the member states or bodies designated by them may allow a partial or complete exemption from the obligation to publish a prospectus if the number or estimated market value or the nominal value or, in the absence of a nominal value, the accounting par value of the shares offered amounts to less than 10 per cent of the number or of the corresponding value of shares of the same class already admitted to dealing, provided that investors already possess up-to-date information about the issuer equivalent to information otherwise required as a result of stock exchange disclosure requirements.[58]

Member states may provide that the person making a public offer shall have the possibility of drawing up a prospectus the contents of which shall, subject to adaptations appropriate to the circumstances of a public offer, be determined in accordance with Directive 80/390/EEC. Such a prospectus is subject to prior scrutiny by the bodies designated by the member states even in the absence of a request for admission to official stock exchange listing.[59]

The member states or the bodies designated by them may authorise the omission of certain information prescribed, if that information is of minor importance only and is not likely to influence assessment of the issuer's assets and liabilities, financial position, profit and loss, and prospects or if disclosure of that information would be contrary to the public interest or seriously detrimental to the issuer, provided that, in the latter case, omission would not be likely to mislead the public with regard to facts and circumstances essential for assessment of the transferable securities.

If the initiator of an offer is neither the issuer nor a third party acting on the issuer's behalf, omission of certain information which would not normally be in the initiator's possession may be authorised.[60] Partial or complete exemption from the obligation to publish a

57 European Community Directive 89/298/EEC, art 11, para 2.
58 European Community Directive 89/298/EEC, art 11, para 8.
59 European Community Directive 89/298/EEC, art 12.

prospectus may be provided for if the relevant information is available to investors not later than the time when the prospectus must be or should have been published or made available to the public, in the form of documents giving at least equivalent information.

Before its publication the prospectus must be communicated to the authority in each member state in which the transferable securities are offered to the public for the first time.[61]

The prospectus must be published or made available to the public in the member state in which an offer to the public is made in accordance with the procedures laid down by that member state not later than the time when an offer is made to the public.[62] If any significant new factor arises or any significant inaccuracy in a prospectus capable of affecting assessment of the transferable securities is noted before a definitive closure of a public offer, such circumstances must be mentioned and rectified in a supplement to the prospectus to be published in the same form as the original prospectus.[63]

In cases of public offers in two or more member states simultaneously or within a short interval, the authority in the member state where the issuer has its registered office will be competent if the public offer or any application for admission to official listing is made in that member state.[64] If this member state does not provide for the prior scrutiny of public offer prospectuses and if only the public offer or an application for admission to listing is made in that member state, the party making the public offer must choose the supervisory authority from those in the member states in which the public offer is made and which provides in general for the prior scrutiny of public offer prospectuses.[65]

A prospectus, approved in accordance with the provisions mentioned above, subject to translation if required, must be recognised as complying or be deemed to comply with the laws of the other member states in which the same transferable securities are offered to the public simultaneously or within a short interval of one another, without being subject to any form of approval there and without those states being able to require that additional information be included in the prospectus, except that those member states may require that the prospectus includes information specific to the market of the country in which the public offer is made concerning in particular the income tax system, the financial organisations retained to act as paying agents for the issuer in that country, and the way in which notices to investors are published.[66]

A prospectus approved in accordance with article 24a of Directive 80/390/EEC must be recognised even if partial exemption or partial derogation has been granted, provided such exemption or derogation is of a type recognised in the rules of the other member state and the circumstances that justify such exemption or derogation exist in the other member state.[67]

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60 European Community Directive 89/298/EEC, art 13, para 2.
61 European Community Directive 89/298/EEC, art 14.
62 European Community Directive 89/298/EEC, arts 15and 16.
63 European Community Directive 89/298/EEC, art 18.
64 European Community Directive 89/298/EEC, art 20, para 1.
65 European Community Directive 89/298/EEC, art 20, para 2.
66 European Community Directive 89/298/EEC, art 21, para 1.
67 European Community Directive 89/298/EEC, art 21, para 2.

Insider Dealing

In respect of insider dealing, the legal basis is Council Directive 89/592/EEC of 13 November 1989, co-ordinating regulations on insider dealing. It was acknowledged that the secondary market in transferable securities plays an important role in the financing of business and that the smooth operation of that market depends to a large extent on the confidence it inspires in investors. Such confidence is supported by the assurance that investors are treated equally and will be protected against the improper use of inside information.[68]

The Directive was meant to co-ordinate rules which differed considerably in member states. 'Inside information' is defined as information which has not been made public of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question.[69]

The Directive demands that member states prohibit any person who, by virtue of his membership in the administrative, management, or supervisory bodies of the issuer, by virtue of his holding in the capital of the issuer, or because he has access to such information by virtue of the exercise of his employment, profession, or duties, possesses inside information from taking advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party transferable securities to which that information relates.[70] The possessor of inside information is prohibited from:

- Disclosing that inside information to any third party unless such disclosure is made in the normal course of the exercise of his employment, profession, or duties; or
- Recommending or procuring a third party, on the basis of that inside information, to acquire or dispose of transferable securities admitted to trading on its securities markets, which are regulated and supervised by authorities recognised by public bodies, operate regularly, and are accessible, directly or indirectly, to the public.[71]

The prohibition is extended to persons who, with full knowledge of the facts, possess inside information, the direct or indirect source of which could not be other than a person as defined above.[72]

68 Preamble of European Community Directive 89/592/EEC.
69 European Community Directive 89/592/EEC, art 1, para 1.
70 European Community Directive 89/592/EEC, art 2, para 1.
71 European Community Directive 89/592/EEC, art 3; European Community Directive 89/592/EEC, art 1, para 2.
72 European Community Directive 89/592/EEC, art 4.