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Section of International Law

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International Securities & Capital Markets Newsletter

Recent Developments in International Securities Law

Dear Committee Members,

This is the third issue of the International Securities & Capital Markets Newsletter, published by the International Securities & Capital Markets Committee of the American Bar Association's Section of International Law. We hope you find it interesting and useful. We plan to publish this newsletter on a quarterly basis and welcome submissions regarding jurisdictions not already covered.

A special note of thanks to our contributors, who have each prepared interesting and informative pieces. If you would like to contribute, and we very much encourage you to do so, or if you have a question or suggestion, please contact either of us using our details at the end of the newsletter.

We hope we will see you at the Annual Meeting later this week and at the Fall Meeting in Brussels, where the Committee will be presenting four programs.

Regards,

Adam Farlow and Charles Farnsworth

Contents

Brazil

SIMPLIFIED ENROLLMENT OF NON-RESIDENT INVESTORS IN BRAZIL

At a session on April 27, 2005, the Brazilian Stock and Exchange Commission (CVM) approved Instruction CVM nº 419, officially dated May 2, 2005, that allows brokerage houses to enroll non-resident investors in the country in a simplified fashion. A non-resident is an individual or collective investor, corporate entity or otherwise, fund or other collective investment entity, residing, domiciled or headquartered abroad.

The non-resident investor must be a client of a foreign intermediary institution with which it is properly enrolled, pursuant to the applicable laws and regulations in the foreign intermediary institution's country of origin. The foreign intermediary institution assumes the obligation before the brokerage houses of presenting, whenever requested: (i) all current information as required in CVM Instructions governing enrollment of investors in the securities market, and (ii) other information required by Brazilian government supervisory agencies.

Brokerage houses will set criteria that enable an assessment of the trustworthiness of the intermediary foreign institution and will take the necessary steps to ensure that whenever requested the client information on record will be immediately supplied by the foreign institution and that the foreign institution has proper practices in place to identify and enroll clients, in keeping with the applicable legislation of the respective country of origin.

In order to do so, it is indispensable that the country in which the foreign intermediary institution is located is not deemed to be a High Risk Country as far as money laundering and funding of terrorism are concerned and, in relation to fighting such illegalities, is not classified by international organisms as a non cooperative country. In addition, the body regulating the capitals market of the country of origin of the foreign intermediary institution must have executed with the CVM a mutual cooperation agreement allowing the parties to exchange financial information about investors.

The rules laid down in the future by the exchanges or organized by over-the-counter market companies and governing the simplified enrollment of non-resident investors should include at least the requirements listed below. Said rules must be submitted to Plenary Decision of the CVM, prior to its initial effectiveness. Exchanges and organized over-the-counter market companies are required to make available to the CVM a current list of agreements existing between foreign intermediary institutions and brokerage houses that are subject to self-regulation. The same requirements apply to the central depositaries, clearing and settlement houses and their respective participants therein, in their relationship with global custodians that act as custodians of non-resident investors' securities.

The rules will determine the mandatory execution of the written agreement by the brokerage house and the foreign intermediary institution. This agreement must include at least the following:

- a representation by the foreign intermediary that it is in possession of record information required in CVM Instructions governing enrollment of investors regarding the securities market, and that it undertakes at all times to keep such information current;

- an undertaking of the foreign intermediary to provide the brokerage house or CVM, within the terms set by stock exchanges or organized over-the counter market management companies or by CVM, are duly updated with supplementary record information on the non resident investors;

- provision to the effect that the Brazilian laws will govern the agreements and the Brazilian Courts will have jurisdiction to settle disputes arising out thereof. Arbitration clauses are allowed so long as there is a clear provision that any such arbitration will take place in Brazil; and

- provision to the effect that the agreement will be terminated in the event of failure to comply with the obligation to supply record information on non resident investors upon request from brokerage houses, stock exchanges and organized over the counter market management companies, or from the governmental supervisory agencies.

Brokerage houses may not enroll clients operating through foreign intermediaries that have failed to fulfill the obligation to supply information on non resident investors, using the simplified methodology.

The deadlines for and fashion in which brokerage houses will communicate the stock exchanges or organized over the counter markets it is a member of, via the execution, termination of or amendment to the agreement, and any default thereunder, will be regulated.

The rules for safekeeping by brokerage houses of the agreements entered into with foreign intermediary institutions as well as the compliance of agreements with brokerage houses will be determined with specific rules pertaining to regular auditing of brokerage houses by the stock exchange or organized over the counter market.

Canada

POLICY INITIATIVES

2005 has not seen many new policy initiatives on the part of the Canadian securities regulators. One item of note is a proposed rule requiring an independent review committee for investment funds. This rule is part of the Canadian securities regulators' initiatives to improve investment fund governance. The proposed rule imposes a minimum, consistent standard of governance for publicly offered investment funds. Under the proposed rule, every investment fund that is a reporting issuer will have to have a fully independent advisory body called the independent review committee (the **IRC**) to oversee all conflict of interest matters faced by a fund manager in the operation of the fund. For any decision by the fund manager that involves or that a reasonable person would assume involves a conflict of interest for the fund manager, the fund manager must establish written policies and procedures that it must follow and refer the matter to the IRC for its review. A decision by the fund manager to engage in certain specified transactions currently restricted by securities legislation must receive the prior approval of the IRC to proceed. For any other proposed course of action by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the fund manager, the IRC must provide the fund manager with a recommendation, which the fund manager must consider before proceeding.

SECURITIES ENFORCEMENT

2005 has seen an emphasis on increased securities enforcement in Canada. The regulators have increased the number of enforcement staff employed by them and for the first time in recent memory, a non-lawyer has been appointed chair of the Ontario Securities Commission (the **OSC**) with a mandate to bring increased resources to bear in the enforcement area.

Coupled with that, the regulators have brought enforcement actions against Hollinger Inc. (which is already the subject of enforcement action in the United States) and secured a conviction for "tipping" in a very high profile case involving an employee of an investment dealer. As it is not common to have successful convictions in Canada in the insider trading/tipping area, this was considered a significant victory for the regulators.

The OSC also issued a decision with significant consequences to the public markets in a proposed going private transaction by the controlling shareholder of Hollinger Inc. The controlling shareholder of Hollinger Inc. and certain other insiders were the subject of a cease trade order issued by the OSC because the corporation had not filed financial statements. Hollinger Inc. applied for a variation of the cease trade order to allow the going private transaction to proceed. Hollinger Inc. argued that its minority shareholders should have a right to consider the offer rather than be subject to the significant uncertainties involving all of its litigation and its dysfunction. The OSC exercised its public interest power whereby it can refuse to vary certain orders if it is prejudicial to the public interest and determined that because of a lack of information provided to minority shareholders, lack of a Board recommendation and other factors surrounding the transaction, it would not vary the cease trade order to allow the transaction to go before shareholders. This was a courageous, and, in some circles, unexpected decision on the part of the OSC as it did not allow the transaction to be placed before the shareholders and in effect determined that it would not be in the public interest to allow the transaction to proceed in its current form.

HEDGE FUNDS

Finally, certain segments of the hedge fund industry in Canada have been experiencing troubles as a result of the collapse of two large hedge funds selling principal protected notes to retail clients. Regulatory investigations are ongoing as to the cause of the collapse. The collapse has led to a significant concern on the part of retail investors and has affected sales of hedge fund products. Regulatory changes in this largely unregulated area are expected as a result of this collapse.

European Union

OVERVIEW

On December 31, 2003, the European Council enacted Directive 2003/71/EC, the Prospectus Directive (the Directive). The Directive provides for the harmonization of the content of prospectuses throughout the European community and enacts a system which requires Member States to recognize a prospectus approved by another Member State's regulatory authority (the competent authority) without additional approval from the competent regulatory agencies of other Member States. This new framework provides issuers with a single "passport" for use throughout the capital markets of the EU making it considerably easier and cheaper for companies to raise capital across Europe. Member States were required to transpose the Directive to their domestic laws or regulations by July 1, 2005.

The Directive is merely the basis for the prospectus regulatory regime and not an exhaustive set of information requirements; the EU adopted a multi-tier approach to securities regulation. The Directive, the first level, only sets-out the framework for the harmonization, this framework must then be implemented by Commission Regulation (EC) No. 809/2004 (the implementing Regulation). The implementing Regulation is based upon the advice and recommendations submitted by the Committee of European Securities Regulators (CESR), a group composed of representatives of the chief securities regulators of each Member State. The CESR is then charged with making sure that the Directive and the implementing Regulation are applied uniformly by each Member State.

FORMAT

Article 5(3) of the Directive allows the issuer to draw up the prospectus as a single document or separate documents. When the latter option is chosen, the Directive provides that the required information be divided into three parts: the registration document, a securities note, and a summary note. The registration document provides information relating to the issuer; the securities note contains information concerning the securities offered to the public or to be admitted to trading on a regulated market; and the summary is a concise version of the previous two documents and a list of risk factors. The separate document option is beneficial for issuers who already have a registration document approved by the competent authority because they are only required to draw up the securities note and summary note when offering additional securities in later offerings. The registration document is valid for a period of 12 months providing the issuer has complied with the Article 10 information requirements. Similar to U.S. reporting requirements, Article 10 requires the issuer to at least annually provide a document that contains or refers to all information that they have published or made available to the public over the preceding year in one or more Member States. The separate document option is somewhat similar to the shelf registration allowed in the U.S., but is not analogous to the SEC Rule 434 "piecemeal" statutory prospectus, which is only applicable to certain qualified offerings, generally offerings registered on Form S-3.

As part of the process of restructuring the prospectus requirements, the Directive heavily accentuates the importance and the requirements of the summary. The summary is the only document that the host Member State's competent agency can require to be translated into its official language. Therefore, the summary may be the only document used by speakers of that Member State's official language to make an informed decision on whether to purchase the offered securities. The Directive briefly outlines the required content of the summary in Annex I (for summaries included in a single document prospectus) and Annex IV (for the summary note), including the following requirements:

- Identity of directors, senior management, advisers and auditors;
- Key information concerning selected financial data; capitalization and indebtedness; reasons for the offer and use of the proceeds; risk factors;
- Information concerning the issuer;
- Operating and financial review and prospects;
- Major shareholders and related-party transactions;
- Financial information; and
- Details of the offer and admission to trading.

A more detailed description of the format requirements for both the single and separate document prospectuses is found in Article 25 of the implementing Regulation. Both types of prospectuses require a summary section and as mentioned above, the summary can be the most important part of the prospectus because of the language requirements of Article 19 of the Directive. Where an offer to the public is made or admission to trading on a regulated market is made only in the home Member State (the Member State where the issuer has its registered office), the prospectus must be drawn up in a language accepted by the competent authority of the home Member State, which may be a language other than that country's official language.

The previous regime was a system of mutual recognition subject to certain conditions, such as full translation of the prospectus and the possibility that the host country authority could introduce additional requirements. Under the Directive, when the public offer is made or admission to trading on a regulated market is sought in one or more Member States excluding the home Member State, the prospectus may be drawn up either in the language accepted by the competent authorities of those Member States or in a language customary in the sphere of international finance, at the choice of the issuer. The competent authority of each host Member State (the State where an offer to the public is made or admission to trading is sought, when different from the home Member State) may only require that the summary be translated into its official language. Therefore the summary may be the only document used to market an offering in that host country.

DISCLOSURE

Article 5(1) of the Directive requires that the prospectus "contain all information which according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial positions, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities." The Directive simply lays-out the framework for disclosure and does not elaborate on the specific content required for each of the items listed above. Pursuant to Article 7(1) of the Directive, the task is left to the implementing Regulation to determine the 5(1) information requirements. The disclosure requirements are determined by both the type of security being issued and the type of issuer involved and are found in the Annexes to the implementing Regulation.

The required information that must be disclosed in both the Registration Document and the Securities Note is found in a combination of schedules and building blocks. Annex XVIII is an easy reference containing two Tables of Combinations that are used to decipher the required schedules and buildings blocks; the first table is for the registration document, the second for the securities note. The schedules include: Shares (equity securities), Debt and Derivative Securities (< € 50,000), Debt and Derivative Securities (= € 50,000), Asset Backed Securities and Banks Debt and Derivative. Depending on the complexity of the security, more than one schedule may be required. The schedules and building blocks can be found in Annexes I through XVII.

For example, an issuer who is issuing common stock would look to the first Table of Combinations and would be required to use the Share Schedule found in Annex I; therefore, their registration document must conform to the minimum disclosure requirements for the share registration document. The required information is similar the information required in the summary listed above. Furthermore, according to first Table of Combinations in Annex XVII, the registration document must also include the information required in the Pro Forma Information Building Block found in Annex II. Pro forma information refers to the presentation of financial statements that represent proposed events in the form in which they will appear if or when the event actually occurs, in this case, the impact of the to-be-issued securities. In the second Table of Combinations, the issuer will find the disclosure requirements for the Securities Note, the second part of the prospectus that must be included in order to meet the Article 5(1) prospectus requirements. According to that table, common stock would only require the Minimum Disclosure Requirements Schedule and no building blocks. This Schedule is broken down into ten sections, each with a number of subsections laying out the requirements. The subsections include basic information such as the currency of the securities to be issued, terms of the offer, whether the securities will dilute current shareholders.

The information requirements are all unambiguous except for an important part of the securities note, section 2: Risk Factors. This section requires "[p]rominent disclosure of risk factors that are material to the securities being offered and/or admitted to trading in order to assess the market risk associated with these securities." In its recommendation dated February 2005, the CESR indicated that the materiality test can be found in Article 5.1 as described above, "all information which . . . is necessary to enable investors to make an informed assessment. When information is not material in the context of the securities or the issuer, CESR does not expect issuers to mention it. The competent authorities of each Member State have the final say over whether an admission or omission is material. At first glance this appears to be a discrepancy in the materiality requirement from country to country. However, in addition to its responsibility for making recommendations regarding the implementing measures, the CESR is charged with the task of promoting consistent application of the implementing measures. This task may be less complex than it seems, given that the members of the CESR are representatives from each competent authority in every Member State, so there should be presumably less friction between the CESR and the respective competent authorities.

ADDITIONAL INFORMATION

- Copies of the Prospectus Directive and the implementing measures, along with other resources can be found at:

  http://europa.eu.int/comm/internal_market/securities/prospectus/index_en.htm

- The Committee of European Securities Regulators (CESR) can be found at: http://www.cesr-eu.org

India

SUPREME COURT APPLIES FOREIGN LAW TO “CONTROL”

The highest court ruled in a landmark judgment that where an Indian company saw a shift in control because of change of control of a foreign parent, the definition of control in the foreign country would apply rather than the definition of control under Indian law. The judgment violates the gestalt of the takeover regulations and applies some obscure principles of international law ignoring the mandate of Indian law and economics. Ironically, it applies a crude definition of control as defined by French law in place of a more refined definition in India.

The court bases its judgment on whether the Indian target constituted a substantial part of the assets of the foreign company - an irrelevant enquiry as the shareholders of the target are meant to be safeguarded in case of change of control. Rather, the relevant enquiry is whether the parent owns controlling shares of the subsidiary - a bottom up approach rather than the top down approach used in the judgment.

UBS BARRED

The securities regulator passed an order barring UBS and its affiliates from entering into offshore derivatives instruments (ODIs) for a period of one year. ODIs give an offshore entity an economic equivalent to holding Indian equity. The regulator has been investigating since last year the largest ever fall in the Indian stock market on May 17, 2004. The order is not based on any charges of manipulation - which are pending further investigation. Instead, the charges relate allegations of the poor compliance of UBS of its ‘know your client’ mandate and obstructing investigation. The order is a sad development because the dramatic fall in the indices on that day was clearly not occasioned by manipulation but by an electoral result which brought the Congress party to power against every expectation. As one international publication put it: short of UBS stuffing ballot boxes with fake votes, there is no other way UBS and others could have caused a market meltdown.

TAXATION OF FIIs

The Comptroller and Auditor General of India (CAG), the country’s auditor, raised concerns about the use of double taxation treaties, particularly the Mauritius one, by Foreign Institutional Investors (FIIs) to escape tax even though there is no parliamentary approval for such executive treaties. These concerns have already been addressed by a Supreme Court judgment which has given its imprimatur to such executive treaties which are binding on the government but not on citizens of the country. The Mauritius treaty is in any case limping with the introduction of the Securities Transaction Tax which imposes a transaction based fee on most listed securities transactions instead of the capital gains tax earlier in vogue.

COMPANIES ACT RECOMMENDATIONS ON CORPORATE GOVERNANCE

The JJ Irani Committee (the Committee), set up to draft a more current companies’ bill to replace the 1956 Companies Act, came out with its recommendations. The Committee proposed introduction of standards of corporate governance in unlisted companies. The introduction of dozens of corporate governance norms like audit committees in unlisted companies is deeply flawed and fails in understanding that corporate governance is needed only with a divorce of control from ownership - a situation possible only when a company goes public and is thus listed. Unlike in America, unlisted companies in India have no liquidity and there is no “public interest” in such companies. The recommendations also prescribe different standards from those set by the securities regulator causing potential friction and a cottage industry in seminars on the topic.

IDENTIFICATION SCHEME DILUTED

With the change of guard at the securities regulator, a committee was appointed to look at the identification program previously begun by the regulator. With the committee report out in the last week of June, the unusual scheme of fingerprinting all intermediaries and investors seems to be on its way out and a less invasive and more reasonable scheme appears to be arriving. Investors had raised a cry based on invasion of privacy and questioned the need to identify potential victims instead of potential perpetrators of wrongs. At around the same time the UK government plans to introduce national IDs with three biometric identifications for identifying all its citizens, a move which will likely gain more support after the July 7 blasts in London.

TAKEOVER REGULATIONS TRIGGER

Where an agreement is entered into between an acquirer and seller but is not signed and not acted upon, no compulsory tender offer is triggered according to the Securities Appellate Tribunal. The trigger is based on the “entering into an agreement for acquisition of shares or voting rights”, and merely a plan as evidenced by written material may not be determinative of an agreement. Agreements must evidence meeting of minds. Though meeting of minds does not require paper, the judgment rules that the mere presence of paper will not demonstrate meeting of minds.

DEMUTUALIZATION OF BSE DRAWS IRE

Brokers of the century old exchange Bombay Stock Exchange (BSE) have to trade in their seats for two distinct benefits - the right to trade and ownership rights of the exchange. The erstwhile brokers would get 10,000 shares in the newly formed limited company Bombay Stock Exchange. Uncertain about the value of these shares, brokers are up in arms against the proposal and want better terms in return for ceding control of the exchange. At least 51% of the shares need to be held by non-trading shareholders with no trading shareholder permitted to hold over 5% voting rights either alone or in concert.

BSE TO SUSPEND SPICES

An index-based fund called Spices (an Exchange Traded Fund) was suspended from trading when it touched several times its asset value - a value determined by the underlying index. The absurd price should make the regulator think of liberalizing short selling rules which offer an effective means of puncturing such inflated prices in an otherwise efficient market. Institutions are prohibited from short selling in the market and retail investors, though permitted to short, have no effective access to borrowing stock to sell short.

OTC DERIVATIVES REGULATIONS MAY BE MODIFIED

While exchange rate and interest rate derivatives fall under the scanner of the central bank, futures and options in securities are regulated by the securities regulator. From 1969 to 2000, futures and options in securities were prohibited, a bar lifted only when exchange traded futures and options were introduced and then too only for such instruments traded on the exchange. Over-the-counter (OTC) derivatives in securities continue to be prohibited because of the dated prohibition. The central bank is attempting to push for removal of the ban while the securities regulator is more circumspect.

Mexico

PROPOSED NEW MEXICAN STOCK MARKET LAW

On April 5, 2005, the Mexican administration sent the Congress a proposal to create a new Stock Market Law, replacing the current law dating from 1975. The bill was promptly approved by the Mexican Senate by a 77-1 vote and will be considered by the Chamber of Deputies during the Mexican Congress' next period of ordinary sessions beginning on September 1.

The proposed law adopts a number of measures aimed at increasing the relevance of the Mexican stock market, the Bolsa. Currently, only about 150 companies are listed on the Bolsa and, of these, no more than 80 trade on any given day. This level of activity is far below that seen in other comparable economies. Commonly cited reasons for this anemic performance are the difficult regulatory hurdles that companies must overcome in order to list their shares and the scant protection for minority shareholders' rights offered by Mexican corporate law.

The proposed new Stock Market Law aims to remove these barriers by creating a new class of companies that may sell shares on the Bolsa without complying with the full panoply of currently-existing regulations as well as by improving corporate governance and minority shareholders' rights among all companies that sell shares on the Bolsa. The law also increases the power of the regulatory authorities, lengthening the statute of limitations for certain offenses and permitting the regulators to publicly announce disciplinary measures when they are taken, rather than waiting for drawn-out court proceedings to finish.

The New Sociedad Anónima Promotora de Inversión

The proposed law permits the creation of a new type of company called a Sociedad Anónima Promotora de Inversión Bursátil (Stock Investment Promotion Company, or SAPIB). If a company is created as a SAPIB, it will be able to list its shares on the Bolsa without having to comply with all of the reporting requirements currently imposed on publicly-traded companies. However, companies can only list as SAPIB's for a maximum of three years before moving on to the ordinary regime, and their shares can only be sold to certain qualified and institutional investors, subject to certain regulations that will be issued in the future.

Among other characteristics, SAPIB's will provide significant protections for minority shareholders, permitting them, for example, to name a member of the Board of Directors or call a shareholders' meeting if they own at least 10% of the company's outstanding shares. Minority shareholders will also have recourse to the courts against company actions that unfairly prejudice their interests. SAPIB's will also be obligated to have Boards of Directors, and will not be able to opt for administration by a Sole Administrator, as ordinary Mexican corporations may do. Thus, significant minority shareholders will be guaranteed a voice in the company's administration, since they will be represented on the Board of Directors.

Finally in this regard, the proposed law explicitly permits SAPIB's to include shareholders' agreements in their bylaws with respect to issues such as limitations on sales of shares and shareholder voting agreements. Such agreements are prohibited by the Federal Companies' Law for ordinary Mexican companies, although in practice company bylaws sometimes contain the equivalent of shareholders' agreements.

Measures Affecting Other Listed Companies

The proposed law also includes various measures that will apply to all listed companies:

- Listed companies will now have to give detailed information regarding their subsidiaries' results;
- Chief executive officers will have direct legal responsibility for their companies' day-to-day operations and accounting records, leaving boards of directors with responsibility for strategic decisions only;
- The figure of the statutory auditor, or comisario, is abolished. The statutory auditor's functions will be taken over by the company's outside auditor;
- A type of Business Judgment Rule is adopted to shield the officers and directors from liability for their good faith decisions; and
- Shareholders owning at least 5% of the company's shares will have access to the courts to challenge decisions made by the officers or directors that allegedly prejudice their interests.

In sum, if and when it becomes law, the new Stock Market Law will significantly modernize corporate governance and increase minority shareholders' rights for all listed companies, as well as ease requirements for smaller companies to be listed.

The Netherlands

IMPLEMENTATION OF MARKET ABUSE AND PROSPECTUS DIRECTIVES

Draft legislation implementing the Market Abuse Directive and the Prospectus Directive has been approved by Dutch Parliament. The legislation is scheduled to become effective as of July 1, 2005. Until then, the Netherlands Authority for the Financial Markets (AFM), which will be the competent authority under the Prospectus Directive in the Netherlands, performs, upon request, pre-screenings of prospectuses for compliance with the Directive. As the implementation will be temporary (in view of the contemplated final implementation in the Financial Markets Supervision Act), the proposal for the implementation of the Prospective Directive only provides for amendments which are imperative to implement the Directive.

RESTRUCTURING OF SUPERVISION OF FINANCIAL MARKETS

Financial Markets Supervision Act

In the process of the restructuring of the supervision of the financial markets, the second part of the proposal for the Financial Markets Supervision Act was sent to Dutch Parliament. The Act shall replace most of the current financial supervisory legislation. The chapter which was sent to Parliament deals with prudential rules, in particular business economic standards, including solvency and liquidity requirements. This chapter will also cover clearing institutions and will include rules regarding the investor compensation and deposit guarantee system. Furthermore, the Minister of Finance has indicated that the structure of the Financial Markets Supervision Act will be amended by introducing a new chapter on market access, which will deal with license or notification requirements for each financial activity, including the relevant conditions and requirements, exemptions, exceptions and the applicable supervisor. This new chapter is intended to allow better insight in the various applicable requirements for each financial activity. As a result of the introduction of this new chapter, the chapters on prudential and conduct supervision will be amended and will become less extensive. The effective date of the Financial Markets Supervision Act has been postponed to July 1, 2006 (the initial effective date was scheduled for January 1, 2006).

Financial Services Act

A proposal for the Decree on Financial Services (further to the proposal for the Financial Services Act itself) was sent to Dutch Parliament. The Decree includes more elaborate provisions in respect of rules laid down in the Act, such as expertise and reliability of financial intermediaries, provision of information and dealing with complaints. The effective date of the Financial Services Act is expected to be October 2005.

POLICY RULE ACT ON THE SUPERVISION OF CREDIT INSTITUTIONS (BANKING ACT)

As of January 2, 2005, the amendment to the 2002 Policy Rule regarding the interpretation of certain key terms of the Banking Act and the Exemption Regulation to the Banking Act became effective. The amendment solves, amongst other things, some practical problems caused by the 2002 Policy Rule. The Policy Rule will be reviewed and amended fundamentally when the Financial Markets Supervision Act becomes effective.

ACT ON THE SUPERVISION OF INVESTMENT INSTITUTIONS

As indicated in previous newsletters, the AFM conducted a survey of the operation of investment funds in the Netherlands and the Commission on Moderning Investment Institutions was installed. Most of the recommendations of this Commission have been incorporated in the proposal for the Decree on the Supervision of Investment Institutions, which provides for more elaborate provisions in respect of rules laid down in the (proposal of the revised) Act on the Supervision of Investment Institutions. The (amended) Act and the Decree are scheduled to become effective in September 2005.

OFFICIAL MARKET OF EURONEXT AMSTERDAM RENAMED EUROLIST BY EURONEXT

As of April 4, 2005 the Official Market of Euronext Amsterdam has a new name: Eurolist by Euronext. This name was introduced earlier in Paris, Brussels and Lisbon and does not have direct consequences for the issuers which are listed on the Official Market. The name change coincides with the integration of Euro.NM Amsterdam and the Official Market. Issuers, who will not request transfer from Euro.NM Amsterdam to the Official Market, will remain listed on Euro.NM Amsterdam. Euro.NM Amsterdam will continue to exist until the last remaining issuer de-lists.

COMMITTEE CAPITAL MARKETS

The AFM installed the Committee Capital Markets on April 13, 2005. This Committee advises the board of the AFM on actual matters, new securities legislation and interpretation of existing regulations regarding public take over bids, market abuse and prospectus. The Committee will also advise on the policy regarding financial reporting and accountant firms. This Committee will take over the activities of the former Advisory Committee Listing Rules and the Committee public take over bids on securities.

New Zealand

SECURITIES LEGISLATION BILL

The Securities Legislation Bill was reported as backed to New Zealand Parliament on June 15, 2005. It is expected that the legislation will be passed and will be in force from November 1, 2005.

It will significantly change various aspects of New Zealand's security and capital markets regulatory regime. The changes include the following:

- Insider trading will now be subject to criminal sanctions, as opposed to previous civil sanctions only;
- The concept of "insider" is significantly expanded;
- A new market manipulation prohibition will be introduced along with a general dealing misconduct prohibition with criminal sanctions available;
- The substantial security holder disclosure regime will only apply to listed voting securities of any particular class but, contrary to earlier versions of the draft, will not be expanded to include in the definition of "relevant interest," a power or control exercised by means of a practice;
- The existing investment advisers and brokers' disclosure regime will be replaced with a single tier disclosure regime;
- The Takeovers Panel will be given jurisdiction in respect of "truth in takeovers" which previously was with the New Zealand High Court;
- The New Zealand Takeovers Code will remove the asset test for code companies and rely on a listing requirement or to have more than 50 shareholders; and
- A market manipulation prohibition will apply in respect of takeovers.

TIMING OF GIVING SUBSTANTIAL SECURITY HOLDER NOTICES

New Zealand, as with most other countries, requires the filing of substantial security holder notices in respect of reaching the 5% relevant interest in a public issuer who is generally listed on the New Zealand Exchange (NZX). Further notices are also required on 1% changes up or down.

The Securities Commission has issued a statement that it considers that the statutory requirements that the notices be given "as soon as the person knows or ought to know" requires the disclosure be made immediately and it is unacceptable to delay such disclosure.

This is particularly relevant for overseas investors making a significant investment in the NZX listed shares.

South Korea

CROSS-BORDER DISCRETIONARY INVESTMENT MANAGEMENT BUSINESS IN KOREA

Currently, the Korean asset management industry has been consolidating and growing rapidly with more and more institutional and retail investors looking for opportunities to invest outside of Korea by way of directly retaining the services of foreign asset management companies in the case of institutional investors or, in the case of retail investors, through investment in domestically-registered funds focused on investing in overseas funds (so-called fund of funds).

In order to cater to the growing demands of Korean institutional and retail investors, leading foreign asset management companies such as U.S.-based Fidelity and the asset management arm of France-based Societe Generale Group have established asset management companies in Korea alone or through joint ventures, which require a substantial financial undertaking since Korean asset management companies need to be capitalized at a minimum of KRW 10 Billion (approximately US$ 10 Million). However, some foreign asset management companies have avoided the burden of establishing a Korean asset management company by resorting instead to obtaining a cross-border discretionary investment management business (DIMB) license in Korea in order to cater to the growing demands of Korean institutional investors, in particular, for its services.

With a cross-border DIMB license, a foreign asset management company without having any business presence in Korea is permitted to solicit business from institutional investors in Korea and manage their assets outside of Korea. Although a cross-border DIMB license has certain limitations and restrictions (such as no delegation to even affiliates), it may well satisfy the purpose of some foreign asset management companies (namely to manage the assets of Korean institutional investors outside of Korea). Since the promulgation of the Indirect Investment Asset Management Business Act (IIAMBA) in January 2004, which consolidated and streamlined various Korean laws governing asset management business in Korea, many foreign asset management companies have been able to now engage in cross-border DIMB without having any business presence in Korea by obtaining a cross-border DIMB license, which was not issued by the regulatory authority prior to the promulgation of the IIAMBA despite such license being available under the then-relevant Korean law. Consequently, prior to the promulgation of the IIAMBA, some foreign asset management companies without any business presence in Korea resorted to conducting cross-border DIMB only with a cross-border investment advisory business license, which was readily issued by the regulatory authority, in violation of the then-relevant Korean law. We note that the regulatory authority authorized to oversee the asset management business in Korea is the Korean Financial Supervisory Commission although most of the administrative and enforcement activities (including licensing and supervision) have been delegated to the Korean Financial Supervisory Service (FSS), a quasi-governmental entity.

In order to be eligible to obtain a cross-border DIMB license in Korea under the IIAMBA, the foreign asset management company as applicant should satisfy the following general criteria:

- Applicant should be duly licensed to engage in DIMB in its country of domicile;
- Applicant should be a corporation duly incorporated under the applicant’s local laws with a paid-in capital or shareholder’s equity of at least KRW 3 Billion (approximately US$ 3 Million);

- Applicant should have at least 4 "qualified investment management experts" involved with the relevant Korean business among its standing officers and employees. "Qualified investment management expert" means a person having been duly licensed or, in some cases, having satisfied the requirements to engage in investment or fund management in his/her country of domicile;

- As of the end of the immediately preceding fiscal year, applicant's net assets should equal or exceed KRW 2 Billion (approximately US$ 2 Million); and

- During the last 3 years, neither applicant nor its largest shareholder or de facto controller should have been subject to a warning or more severe administrative sanction or a criminal fine or more severe criminal punishment from the regulatory authority of its country of domicile.

After obtaining its cross-border DIMB license in Korea, the foreign asset management company should satisfy compliance requirements pursuant to the IIAMBA. One of the major requirements as a cross-border DIMB license holder is to electronically file with the FSS and the industry organization, the Asset Management Association of Korea, a quarterly business report containing information on cross-border DIMB activities in Korea for the relevant quarter such as the aggregate amount of Korean clients' assets under management and fees generated therefrom, which may be accessible by the public. Other major requirements as a cross-border DIMB license holder are as follows:

- Appointment of a local agent in Korea;

- Performance of cross-border DIMB activities only for Korean institutional investors;

- Having DIMB agreements with Korean clients governed by Korean law and any dispute arising therefrom adjudicated exclusively in a Korean court;

- Reporting of investment results to Korean clients at least on a quarterly basis; and

- Holding of Korean clients' assets under management by internationally recognized foreign custodians.

Although certain compliance requirements, limitations and restrictions applicable to a cross-border DIMB license holder are contrary to global asset management practices, we believe that, with increased activities by and involvement of foreign asset management companies in Korea, such requirements, limitations and restrictions will eventually be relaxed to reflect global asset management practices.

Now, with the availability of a cross-border DIMB license in Korea and the growing demands of Korean institutional and retail investors for services of foreign asset management companies, we anticipate that more and more foreign asset management companies previously not interested in catering to Korean institutional and retail investors will seek to enter this lucrative market beginning with a cross-border DIMB license and eventually establishing some form of business presence in Korea, which would help fulfill Korean government's goal of having Korea be a financial hub for Northeast Asia.

United Kingdom

In January 2005, the UK Financial Services Authority (FSA) issued a final notice penalizing Pace Micro Technology Plc for a breach of the continuing obligations under Listing Rules 9.2 and 9.3A (after July 1, 2005 this is now Disclosure Rule 1.3.4R). A number of important practice points both for UK listed companies and their corporate brokers arise from the decision relating to Listing Rule 9.3A. The key issues are set out below.

On January 26, 2005, the FSA announced its decision to fine Pace for two contraventions of the Listing Rules:

- a breach of Listing Rule 9.3A in failing to take all reasonable care to ensure that its interim results announcement of January 8, 2002 did not omit anything likely to affect the import of that announcement; and

- a subsequent breach of Listing Rule 9.2(c) in failing to disclose price sensitive information relating to its expected revenue performance.

The principal points of interest arise from the FSA's comments on Listing Rule 9.3A.

The FSA held Pace to be in breach of Listing Rule 9.3A because Pace failed to disclose in its interim results announcement that credit insurance would no longer be available to Pace in respect of its biggest customer (NTL) for future orders. The FSA agreed with Pace's analysis that this information was not price sensitive, however, because Pace was issuing its interim announcement, it had an obligation under Rule 9.3A to take all reasonable care to consider that the announcement did not omit anything likely to affect the import of the announcement. The FSA concluded that, although not price sensitive, the information was nevertheless material and required disclosure under Listing Rule 9.3A because it affected the import of Pace's interim results announcement. Post July 1, 2005 when the Market Abuse Directive was implemented in the UK, the concept of "price sensitive" information is replaced by "inside information", however, the change in definition would not have made any difference in this case.

Listing Rule 9.3A (now DR 1.3.4R) requires listed companies to take all reasonable care to ensure that information notified to a Regulatory Information Service (an officially designated body used to release information to the market) "is not misleading, false or deceptive and does not omit anything likely to affect the import of such statement, forecast or other information." In concluding that Pace had breached the Rule, the FSA emphasised that Pace's corporate brokers were not consulted on whether the loss of credit insurance for future orders required disclosure. The FSA noted that the company had consulted its financial adviser, its auditors and solicitors, but it is clear that the FSA did not regard that as sufficient. The clear message is that, if there is any doubt at all, a company should consult its corporate brokers as to whether or not an announcement is required.

Pace had stated in its 2000 report and accounts, but not in any statement announced to a Regulatory Information Service (RIS), that "the Company maintains a credit insurance program over its customer portfolio." The FSA rested its analysis of a breach of Listing Rule 9.3A in part on the impression given to the market by the report and accounts. The FSA's approach is clearly capable of applying to other statements made or documents issued publicly by a company even if not announced to a RIS. This means that companies should regularly review all their publicly issued statements and documents and their website to check whether there is anything in them which, were it subsequently to change, might be considered material for disclosure to the market. If there is any doubt, the corporate brokers should be consulted.

The Pace final notice shows the determination of the FSA to force greater disclosure. The most obvious lesson is the need to consult corporate brokers. The more difficult area is the FSA's view that it is possible for information to be material for disclosure without being price sensitive and the lack of clarity as to what then might constitute "material." In those circumstances it would obviously be difficult for lawyers and corporate brokers to give categorical comfort in many cases and this may well lead to a much more cautious view of what requires disclosure.

United States

SEC SECURITIES ACT REFORM FINAL RULES

On November 3, 2004, the Securities and Exchange Commission (**SEC**) issued proposed rule changes under the Securities Act of 1933, as amended (the **Securities Act**) and the Exchange Act of 1934, as amended (the **Exchange Act**) to modernize the securities offering and communication requirements specified thereunder. On June 29, 2005, the SEC voted to adopt these proposals for securities offering reform and the final rules were published on July 19, 2005. Foreign private issuers and domestic issuers will be treated similarly under this proposal.

New Category of Issuer

The new rules established a new category of issuer, a "well-known seasoned issuer" (**WKSI**), for certain large issuers that are followed by sophisticated investors, analysts and the financial press. The WKSI category is intended to supplement the existing categories of issuers, which include seasoned issuers, unseasoned Exchange Act reporting issuers, and non-reporting issuers. The SEC's rationale behind the WKSI category is to recognize that large, well-known issuers tend to have a more regular dialogue with (and are subject to scrutiny by) investors and market participants through the press and other media.

The SEC defines a WKSI as an issuer that is required to file reports pursuant to Section 13(a) or Section 15(d) of the Exchange Act and satisfies the following:

- is not an ineligible issuer (this includes penny stock companies, blank check companies, shell companies, and issuers who have violated the securities laws or who have experienced financial difficulties) and is not making an ineligible offering;
- is current in its reporting obligations under the Exchange Act and timely in satisfying those obligations for the preceding 12 months;
- is eligible to register a primary offering of its securities on Form S-3 or Form F-3; and
- either (i) has outstanding a minimum worldwide $700 million of common equity market capitalization held by non-affiliates ("public float") within 60 days of its eligibility determination date, or (ii) has issued at least $1 billion aggregate amount of non-convertible debt securities in registered offerings for cash during the past three years and registers only debt securities within 60 days of its eligibility determination date.

Liberalization of Communications Related to Registered Offerings

In the new rules, the SEC has relaxed some of the "gun-jumping" restrictions related to communications, procedures and delivery of information in varying degrees, based upon the reporting status of the issuer. For all reporting issuers, regularly released factual business and forward-looking information will now not be deemed to be an "offer", provided that such release is in the issuer's ordinary course of business and consistent with past practice. For non-reporting issuers, factual business information (but not forward looking information) that is regularly released to persons other than in their capacity as investors will not be deemed to be an "offer". The widest latitude is granted to WKSIs, for whom oral and written communications not be deemed to be an "offer" and will include the use of a "free-writing prospectus," but in many cases will require filing with the SEC. Communications occurring more than 30 days before an offering will not be deemed to be an "offer" as long as there is no reference to the offering; this restriction does not apply to WKSIs.

Free-Writing Prospectus

The new rules also permit the use of a "free-writing prospectus" by WKSIs prior to effectiveness of a registration statement and by others after a registration statement has been filed. A free-writing prospectus includes any written or electronic communication outside the statutory prospectus that is made by an issuer or other offering participant, and either refers to the offer or would constitute an offer that would be subject to liability under Section 12(a)(2). Only WKSIs are able to use free-writing prospectuses prior to the filing of a registration statement; non-reporting issuers and non-WKSIs are able to use a free-writing prospectus only upon the filing of a registration statement. In addition, the statutory prospectus must precede or accompany any free-writing prospectus of a non-reporting issuer or non-WKSI. Electronic roadshows are considered free writing prospectuses, and therefore must be filed, unless a copy of the electronic roadshow is posted on the issuer's website and is readily available to the public. Similarly, media interviews are also free-writing prospectuses and, if they involve issuers or underwriters, must be filed with the SEC.

Any free-writing prospectus used by any person is subject to liability under Section 12(a)(2) of the Securities Act and to the antifraud provisions of the securities laws. Because such a prospectus is not deemed to be part of the registration statement, however, it is not subject to liability under Section 11 of the Securities Act.

Registrations and Shelf Offerings

The new rules liberalize the shelf registration process for WKSIs by permitting their shelf registrations to become effective automatically and to register various classes of securities, without allocation or distinction between primary and secondary shares. Furthermore, WKSIs are permitted to pay in advance or to use a "pay as you go" process for payment of registration fees.

The new rules state that for all shelf offerings, prospectus supplements are deemed part of the registration statement. Moreover, the rules essentially codify the information that may be omitted from a base prospectus in a shelf offering and included in subsequently filed prospectus supplements, thereby providing more direction for shelf offering participants. The new rules eliminate the limitation under Rule 415 permitting registration only of the number of shares intended to be sold within two years, instead requiring that the shelf be updated with a new registration statement every three years. Finally, the rules permit immediate shelf takedowns and allow material changes to the plan of distribution described in the prospectus to be made by filing a prospectus supplement.

Research Reports, Rule 134 "Tombstone Ads" and Prospectus Delivery

The SEC also substantially expanded the existing safe harbors available to broker-dealers for research reports, including the types of issuers covered and the conditions to publication or dissemination. The SEC expanded Rule 134 to allow offering participants to communicate a broader range of routine information about the offering, issuer and procedural matters; however, even with this reform, Rule 134 is not permitted to test investor interest in a proposed offering (i.e., "testing the waters"). Finally, there will be no mandated method of prospectus delivery; the SEC filing is deemed to constitute availability for investor consultation (as, "access equals delivery"). Issuers must, however, notify investors that they have purchased securities in a registered transaction.

Revised Required Disclosure In Exchange Act Reports

The SEC now requires additional disclosure in three areas: (i) risk factors; (ii) unresolved SEC staff comments; and (iii) disclosure of status as a voluntary filer under the Exchange Act. First, the SEC has extended risk factor disclosure to annual reports and registration statements, and requires quarterly updates to reflect any material changes with regard to risk factors. The scope of risk factor disclosure under the Exchange Act is the same type of disclosure as in a Securities Act registration statement, namely, the most significant risks facing an issuer.

Also, the SEC now requires all accelerated filers to disclose in their annual reports written SEC comments that were issued more than 180 days before the end of the fiscal year covered by the annual report and which remain unresolved as of the date of the filing of the annual report, and that the issuer believes to be material. This must be sufficient to disclose the substance of the comments, and issuers can include in such disclosure their position resolving any such unresolved comments.

Third, an issuer must disclose its status as a "voluntary filer" of Exchange Act reports in order to inform investors and other market participants that an issuer is a voluntary filer (and may cease to file its Exchange Act reports at any time). This will also enable the SEC to identify voluntary filers more easily in order to monitor such issuers' use of proposed communications rules and other regulatory requirements.

These reforms become effective 120 days after publication in the Federal Register and should therefore become effective by the end of November.

SARBANES-OXLEY SECTION 404 COMPLIANCE DATE EXTENSION

On March 2, 2005, the SEC again extended the compliance date for foreign private issuers regarding amendments to its rules under the Exchange Act that were made in 2003 pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. The amendments require SEC-reporting companies to include in their annual reports a report of management on the company's internal control over financial reporting, and to evaluate, as of the end of each fiscal period, any change in the company's internal control over financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

As a result of the extension granted, a foreign private issuer filing its annual reports on Form 20-F or 40-F must begin to comply with the internal control over financial reporting requirements for its first fiscal year ending on or after July 15, 2006, a one-year extension from the previously established July 15, 2005, compliance date. The SEC similarly has extended the compliance date for these companies relating to requirements regarding evaluation of internal control over financial reporting and management certification requirements.

SEC ACCOMODATION FOR IFRS

On April 12, 2005, the SEC published amendments to Form 20-F providing a onetime accommodation relating to financial statements prepared under International Financial Reporting Standards (**IFRS**) for foreign private issuers registered with the SEC. This accommodation applies to foreign private issuers that adopt IFRS prior to or for the first financial year starting on or after January 1, 2007.

Foreign private issuers that have ongoing SEC reporting requirements are generally required to present, in their annual reports and registration statements filed with the SEC, audited statements of income, changes in shareholders' equity and cash flows for each of the past three financial years, prepared on a consistent basis of accounting.

At the beginning of 2003, the International Accounting Standards Board had not finalized some of the IFRS that many foreign private issuers will be required to apply retrospectively when they adopt IFRS for the first time for year 2005. Consequently, for foreign issuers switching to IFRS, compliance with SEC requirements would have been difficult because these issuers would have be forced to implement accounting standards that were not yet finalized during the reporting period to which they must be applied.

The accommodation permits eligible foreign private issuers for their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders' equity and cash flows prepared in accordance with IFRS, with appropriate related disclosure. The accommodation retains current requirements regarding the reconciliation of financial statement items to generally accepted accounting principles as used in the United States.

RECENT CASE LAW DEVELOPMENTS IN THE UNITED STATES

The first half of 2005 saw some notable decisions handed down by U.S. courts in various securities-related cases. These decisions touch on different aspects of issuer and underwriter liability in the context of sales of securities, and while the impact of these decisions on market practices are not yet fully known, they do represent new developments in securities case law in the United States.

In re WorldCom, Inc. Securities Litigation

The first of these decisions was actually handed down at the end of 2004. On December 15, 2004, the Southern District of New York handed down a decision in the case of *In re WorldCom, Inc. Securities Litigation*, regarding the interpretation of the due diligence and reliance defenses for underwriters and directors under Section 11 of the Securities Act of 1933. Section 11 provides that underwriters are liable for material misstatements or omissions in registration statements covering securities they underwrite.

The underwriter defendants moved for summary judgment to dismiss a class action lawsuit on the grounds that they conducted reasonable due diligence with respect to the WorldCom financial statements because they were entitled to rely upon the audited financial statements without further investigation. In denying the motion for summary judgment the court noted that, while in most situations it would be reasonable for underwriters to rely on audited financial statements, this reliance may not be blind and companies must be on the lookout for "red flags." The court defined a "red flag" as "any information that strips a defendant of his confidence in the accuracy of those portions of a registration statement premised on audited financial statements."

As a result of this decision, plaintiffs in future cases brought under Section 11 will likely allege as a matter of course the presence of one or more red flags in any litigation involving allegedly false audited financial statements. However, if underwriters identify the red flag as part of their diligence investigation and engage in a well documented investigation of the facts giving rise to the red flag, then under the court's reasoning the underwriters would be entitled to the reliance defense.

EBC I, Inc. v. Goldman Sachs (eToys)

In June 2005, the Court of Appeals of New York, in *EBC I, Inc. v. Goldman Sachs*, ruled that a lead managing underwriter of an initial public offering may be sued for a breach of fiduciary duty cause of action. Goldman Sachs (**Goldman**) had been the lead underwriter of the IPO of eToys (since renamed EBC I, Inc), an online toy retailer. Approximately two years after the IPO, eToys filed for bankruptcy. The committee of unsecured creditors sued Goldman in the New York courts for beach of fiduciary duty, claiming that the defendant had breached a fiduciary duty to eToys through an undisclosed conflict of interest.

The New York Court of Appeals held that this complaint could not be dismissed on the pleadings and noted that while a court normally looks to a contractual agreement to determine if a fiduciary relationship exists, liability is not dependent solely on such an agreement. The court stated that “to the extent that underwriters function, among other things, as expert advisors to their clients on market conditions, a fiduciary duty may exist,” but also stressed that “the fiduciary duty we recognize is limited to the underwriter’s role as advisor.”

The court’s discussion of the contractual relationship of the parties suggests that a disclaimer, denying any role as advisor, may be an important step in protecting underwriters. However, the court’s language appears to require that the disclaimer truly reflect reality in order to be effective under New York law.

Dura Pharmaceuticals, Inc. v. Broudo

On April 19, 2005, the United States Supreme Court handed down the decision in *Dura Pharmaceuticals, Inc. v. Broudo* with a ruling regarding loss causation in the context of a securities fraud class action. A securities fraud class action was filed against Dura Pharmaceuticals (**Dura**) alleging that some of Dura’s managers and directors made misrepresentations about future Food and Drug Administration approval of a new asthmatic spray device, leading the class members to purchase Dura securities at an artificially inflated price.

The Court held that an inflated purchase price will not by itself constitute or proximately cause the relevant economic loss needed to allege and prove loss causation. The Court required instead that a plaintiff in a securities fraud lawsuit plead and prove a causal connection between a company’s alleged misrepresentations and a subsequent loss in stock value. This will typically require the plaintiff to plead and prove that the stock price dropped because the true facts related to the alleged misrepresentation were revealed.

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