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International Investment and Development Committee

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International Investment and Development Committee

I. Brazil*

A. The Opening of the Reinsurance Market in Brazil

One of the major developments in Brazil in 2007 was the opening of the Brazilian reinsurance market to the private sector, including foreign investors, with the end of the reinsurance and retrocession monopoly granted to IRB-Brasil Resseguros S.A. (IRB), the state-controlled Brazilian reinsurance company. This new policy was adopted through the enactment of Supplementary Law No. 126 of January 15, 2007.[1] The regulations, which are necessary to implement the new policy, will be announced at the end of 2007 by the Brazilian Superintendent of Private Insurances (*Superintendência de Seguros Privados* or SUSEP) pursuant to the guidelines established by the Brazilian Council of Private Insurances (*Conselho Nacional de Seguros Privados* or CNSP).[2]

For the purposes of the new legislation, an assignor (*cedente*) is the insurance company that contracts the reinsurance or the reinsurer that contracts the retrocession transaction. Co-insurance (*co-seguro*) is the insurance transaction in which two or more insurance companies, with the consent of the insured, share the risks of a certain insurance policy, according to the agreed percentages, without assuming any joint and several liability. Reinsurance (*resseguro*) is the transaction whereby the risks are transferred from the assignor to the reinsurer. Retrocession (*retrocessão*) is the transaction whereby the reinsurance risks are transferred from the reinsurer to other reinsurer(s) or from the reinsurer to local insurance company(ies).[3].

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1. Lei Complementar No. 126, de 15 de janeiro de 2007, D.O.U. de 16.01.2007. (Brazil), *available at* http://www010.dataprev.gov.br/sislex/paginas/43/2007/126.htm. This new legislation governs reinsurance, retrocession and its intermediation, the co-insurance operations, the contracting of insurance abroad and the foreign currency transactions in the insurance sector.

2. SUSEP, About Brazilian Insurance Market, http://www.susep.gov.br/menuingles/about_bim.asp (last visited Apr. 12, 2008). The regulatory functions formerly attributed to IRB are now assumed by CNSP and SUSEP. CNSP is the Brazilian insurance regulatory body, which establishes the guidelines that are implemented by SUSEP. SUSEP is the entity responsible for the inspection of the insurance companies, reinsurers, insurance brokers, and the like. The draft regulations on co-insurance, reinsurance, retrocession and reinsurance brokerage transactions, as well as for the activities of the representative offices of admitted reinsurers, are available at www.susep.gov.br and were submitted by SUSEP for public review and comment of market players, participants, and prospective investors in October 2007 and are expected be revised with these contributions and announced by the end of 2007.

3. Lei Complementar No. 126, *supra* note 1, art. 2, § 1 (I-IV).

There are three types of reinsurers: (a) local reinsurer (*ressegurador local*); (b) admitted reinsurer (*ressegurador admitido*); and (c) eventual reinsurer (*ressegurador eventual*), as described below.

A local reinsurer is one which is headquartered in Brazil and incorporated as a corporation (*sociedade anônima*) with the sole and exclusive purpose of making reinsurance and retrocession transactions.[4] Therefore, a Brazilian reinsurance company controlled by foreign residents or that is a wholly-owned subsidiary of an international insurance company is deemed to be a local reinsurer. IRB is also considered a local reinsurer [5] and will have to compete with all the other reinsurers.[6]

An admitted reinsurer is one which is headquartered outside Brazil but has a representative office in Brazil that is registered as such with SUSEP to make reinsurance and retrocession transactions.[7]

An eventual reinsurer is a foreign reinsurance company that does not have a representative office in Brazil and is registered with SUSEP to make reinsurance and retrocession transactions.[8] Foreign companies domiciled in tax haven countries cannot be registered as eventual reinsurers in Brazil.[9] Under Brazilian law a "tax haven country" (*paraíso fiscal*) is a jurisdiction which does not impose any taxation on income or where the applicable rate is below 20 percent or whose legislation requires secrecy about the capital stock structure of the legal entities or about their ownership.

A local reinsurer is subject to the same rules that apply to a Brazilian insurance company.[10] An admitted or eventual reinsurer must comply with certain minimum requirements[11] to operate in Brazil, namely:

- to be incorporated in accordance with the laws of its country of origin in order to subscribe local and international reinsurance in the same fields in which it intends to operate in Brazil and be able to demonstrate that it has carried out its activities in the place of its incorporation for more than five years;
- to have the minimum economic and financial capacity established by CNSP;
- to be the bearer of a solvency evaluation classification determined by a rating agency recognized by SUSEP and pursuant to the parameters determined by CNSP;
- to designate an attorney-in-fact domiciled in Brazil with full administrative and judicial powers, including but not limited to the receipt of service of process, to whom all summons and notifications may be addressed and delivered; and
- to satisfy other criteria to be set up by CNSP.

In addition to these requirements, each admitted reinsurer must also maintain a foreign currency account linked to SUSEP, in the form and amount to be defined by CNSP, in

4. *Id.* art 4.

5. *Id.* art. 22. IRB lost the monopoly and its regulatory functions but kept the status of local reinsurer in view of a grandfather provision included in the new.

6. IRB will have a period of at least 180 days to adapt to the new regulations on co-insurance, reinsurance, and retrocession to be enacted by CNSP.

7. Lei Complementar No. 126, *supra* note 1, art. 4 (II).

8. *Id.* art. 4 (III).

9. *Id.* art. 4.

10. *Id.* art. 5.

11. *Id.* art. 6 (I-V).

order to guarantee its transactions in Brazil, and from time to time present its financial statements in the form determined by CNSP.[12] The contracting of reinsurance or retrocession in Brazil or abroad may be made either by means of a direct negotiation between the assignor and the reinsurer or through a legally authorized intermediary.[13] The maximum limit to be assigned yearly to eventual reinsurers will be set forth by the Executive Branch.[14] In order to be legally authorized, the intermediary must be an authorized reinsurance brokerage house organized under Brazilian law with professional civil liability insurance in the form defined by CNSP. In addition, responsibility for the operations of the intermediary must be placed with an individual who is a duly accredited insurance broker.[15]

Under the new law, risk transfer is only allowed in: (i) reinsurance transactions with local, admitted or eventual reinsurers; and (ii) retrocession transactions with local, admitted or eventual reinsurers or local insurance companies.[16] The new legislation creates a market reserve in favor of the local reinsurers. Subject to the rules to be issued by CNSP, the assignor will contract or offer the first refusal right to local reinsurers comprising, at least: (a) 60 percent of its reinsurance assignments, during the first three years counted as from January 16, 2007;[17] and (b) 40 percent of its reinsurance assignments, after the fourth year.[18].

B. Brazilian Infrastructure Funds

Another important development in Brazil is the creation of a new type of mutual fund with the specific purpose of investing in infrastructure projects in Brazil.[19] These funds are known as Investment Funds for Participation in Infrastructure (*Fundos de Investimento em Participações em Infra-Estrutura*) and are commonly referred to as FIP-IE.[20]

The FIP-IE must have at least 95 percent of its net worth invested in shares or subscription bonus of Brazilian corporations (*sociedades anônimas*), publicly-held or closely-held, which develop new infrastructure projects in Brazilin the sectors of: (i) energy; (ii) transportation; (iii) water and basic sanitation; and (iv) irrigation.[21] The new law applies both to projects that are implemented after January 22, 2007, and projects existing on that date that are subsequently expanded, provided that in the latter case the investments and the results of the expansion must be segregated by means of the formation of a Specific Pur-

12. *Id.* art. 6 (I-II).
13. *Id.* art. 8.
14. *Id.* art. 8, § 1.
15. *Id.* art. 8, § 2.
16. *Id.* art. 9.
17. That is, as from the date of publication of Supplementary Law 126 in the DOU (Brazil), when it came into force.
18. Lei Complementar No. 126, *supra* note 1, art. 11 (I-II).
19. Comissao de Valores Mobiliarios, Instrucão CVM No. 460, de 10 de octubro de 2007, Nov. 10, 2007 (Brazil), *available at* http://www.bovespa.com.br/pdf/CVM460.pdf. The matter is governed by CVM, the Brazilian securities and exchange commission.
20. *Id.* art. 3. According to article 3 of CVM Instruction 460, the name of the fund must have the expression in Portuguese "*Fundo de Investimento em Participações em Infra-Estrutura*" and cannot contain any name or expression which may lead to an erroneous interpretation regarding its purpose, its investment policy, or its public-target.
21. *Id.* art. 4.

pose Company (SPC).[22] The fund will have 180 days from the date of its incorporation to comply with and achieve the required percentage investment (95 percent).[23] The same 180-day period is also applicable to correct any eventual unframed situation arising out of the termination of a project in which the FIP-IE has invested.[24]

Companies with infrastructure projects that receive investment from a FIP-IE must adopt the following corporate governance practices:[25]

- prohibit the issuance of participation certificates (*partes beneficiárias*), also known as founding shares;[26]
- establish a unified term of office of a maximum of two years for all the members of the Board of Directors (*Conselho de Administração*);
- make available agreements with related parties, shareholders' agreements, and purchase option programs issued by the company;
- adopt arbitration for the resolution of corporate disputes;
- provide for annual auditing of financial statements by independent auditors duly registered with the CVM; and
- in the case of capital issuance, assume the obligation vis-à-vis the fund to adhere to specific regulations of the stock exchange or of the organized over-the-counter market.

Any FIP-IE must have, at least, ten quotaholders, which are similar to shareholders. Each quotaholder cannot hold more than 20 percent of the total quotas issued by the fund and may not be entitled to receive earnings above 10 percent of the total income of the fund.[27] Informational material of the fund, including any prospectus, must highlight: (i) the risk of low liquidity of the assets in which the fund may invest; and (ii) the tax benefits which are available to the fund and the quota-holders, if that is the case, and the conditions which should be followed in order to keep such benefits.[28]

II. Chile*

In December 2006, a bill was introduced in the Chilean Congress to amend the Social Security Law and the Banking Law.[29] The main purpose of this bill is to create opportunities for competition in the social security sector, drive down pension management fees and generally de-concentrate the market.[30] The most important banking-related modifi-

22. *Id.* art. 4, § 1.
23. *Id.* art. 4, § 2.
24. *Id.* art. 4, § 3.
25. *Id.* art. 5 (I-VI).
26. Lei No. 6.404, de 15 dezembro de 1976, D.O.U. de 17.12.76. (Brazil). Founding shares are negotiable securities of no par value and unrelated to the capital of the company which confer on their owners the right to a possible participation in the annual profits of the company.
27. Instrucão CVM No. 460, *supra* note 19, art. 6.
28. *Id.* art. 7 (I-II).

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29. Boletín No. 4742-13, de 19 de diciembre 2006. (Chile) (regarding the improvement of the pensions of retirement system), *available at* http://sil.congreso.cl/pags/index.html.
30. *See* Legislatura 355, Sesion 59, Diario de Sesiones del Senado, 17 de octubre de 2007 (Chile), *available at* http://sil.congreso.cl/pags/index.html.

cation proposed by the bill is to allow commercial banks to engage in the management of pension funds through the creation of subsidiaries or related entities in the form of *administradoras de fondos de pensiones* ("AFPs").[31] These AFPs are government-supervised, single-purpose corporations exclusively dedicated to the management of pension funds and the disbursements provided under the Social Security Law.[32]

In order to avoid undesirable consequences stemming from the banks' participation in the social security system, the bill includes safeguards to prevent conflicts of interest in fund management and the marketing of social security services, such as a prohibition on tying or combining the sale of financial or banking products with membership in the related AFP. Other safeguards contemplated in this regard include a mandatory separation of the AFP's business functions and activities from those of other entities within the AFP's corporate group and ownership structure, and the prohibition on investment by the retirement funds in financial instruments issued by entities related to the AFP.[33]

The bill was preliminarily approved by the Senate on October 17, 2007, but awaits certain legislative procedures and approvals before it can be enacted as law.[34]

III. Colombia.*

On May 6, 2007, the Board of Directors of the Colombian Central Bank introduced[35] a deposit obligation in connection with "non-perfected foreign investment transactions" (wire transfers initially remitted for purposes of capital investments that end up being repatriated without being used for the initial objective), pursuant to which a mandatory six-month, non-interest bearing deposit needs to be made with the Central Bank in an amount equivalent to 40 percent of the value of any such transactions. Although the deposit obligation has existed since the enactment by the Central Bank of the Colombian Foreign Exchange Regime in 2000,[36] it was understood to apply only to domestic debt transactions and therefore its application to foreign investment transactions constitutes an extension of the original requirement.[37]

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31. *See, e.g.*, Altura Management, Reforma Previsional: ¿Qué pasa con los independientes?, Aug. 2007, *available at* http://www.lasegunda.com/ediciononline/economia/estudios/reforma_previsional.pdf. *See generally*, Superintendent of AFP, www.safp.cl (last visited Mar. 18, 2008). Pursuant to the Chilean Social Security Law, personal retirement funds are administered by AFPs that manage the amounts that future pensioners or beneficiaries deposit into individual capitalization accounts. Chilean employees are free to choose the AFP that will manage their retirement funds, but they are obligated to deposit a minimum amount monthly unless they are self-employed. AFPs have their own capital, segregated from the savings deposited by the beneficiaries (or by their employers on their behalf). Because there are only six active AFPs, some experts believe that the market has become excessively concentrated and requires new participants to increase competition.

32. Boletín No. 4742-13, *supra* note 29.

33. *Id.*

34. *See* Legislatura 355, *supra* note 30.

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35. By means of Resolution 2, modified by Resolution 6 on June 15, 2007.

36. Resolucíon Exlema No. 8, 5 de mayo de 2000 (Colombia), *available at* http://www.banrep.gov.co/documentos/reglamentacion/pdf/Res8-2000.pdf.

37. It is worth mentioning that, initially, Resolution 2 waived the deposit obligation if the monies were sent back abroad within 180 days from the date of entry into Colombia. But Resolution 6 changed this provision and established that the obligation applies in respect of any repatriation of unused investments. The only exception permitted by current regulations is the remittance of balances of foreign investment transfers whenever such balances originate from differences in the exchange rate applied, provided, however, that their

The deposit obligation has a further implication regarding foreign investment activities. Current regulations expressly exclude foreign loans entered into by Colombian residents which are intended to finance Colombian capital investment abroad from the deposit obligation. Given the original intention behind this deposit obligation was to control foreign exchange balances, this exception is justified in light of the fact that this type of transaction does not entail the entry of any foreign currency into Colombian territory.

IV. India*

In September 2007, the Securities and Exchange Board of India (SEBI) raised the limit for overseas investments by Indian mutual funds from $200 million to $300 million per fund; however, the aggregate ceiling for overseas investments remains unchanged at $5 billion.[38]

Mutual funds can now also invest in new categories of overseas instruments, such as ADRs/GDRs issued by foreign companies, initial and follow-on public offerings at recognized stock exchanges overseas, foreign debt securities in countries with fully convertible currencies with ratings not below investment grade, and money market instruments rated not below investment grade.[39] In April 2007, the Union Finance Ministry introduced new guidelines for foreign investment in preference shares, the effect of which is to treat fully convertible foreign capital as part of share capital.[40]

The Indian government also raised the foreign direct investment (FDI) ceiling in the telecom sector from 49 percent to 74 percent.[41] The new guidelines automatically allow FDI up to 74 percent and mandate extensive security conditions that investors are required to follow, such as requiring that the Chief Officer in charge of technical network operations and the Chief Security Officer should be resident Indian citizens and that information transacted through a network by the subscribers is secure and protected. The Indian government also now allows 100 percent FDI in Internet Service Providers (ISPs) without gateway, infrastructure providers providing dark fibre, and electronic mail and voice mail, provided that these companies, if they are listed outside India, set aside 26 percent of their equity for the Indian public within five years. The approval of the Foreign Investment Promotion Board (FIPB) is required for foreign investment beyond 49 percent.[42]

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value does not exceed 5 percent of the original amount channelled through the Colombian foreign exchange market.

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38. Memorando from Executive Dir., Inv. Mgmt. Dept., SEBI Circular, Overseas Investments by Mutual Funds, SEBI/IMD/CIR No.7/104753/07, at 1 (Sept. 26, 2007), *available at* http://www.sebi.gov.in/circulars/2007/ciroverseas.pdf.

39. *Id.*

40. Press Release, Ministry of Fin., Guidelines for Foreign Investment in Preference Shares, File No. 1/16/2002-FIU (June 26, 2007), *available at* http://finmin.nic.in/the_ministry/dept_eco_affairs/investment_div/PressNote_FI_PrefShares.pdf.

41. Press Release, Dept. of Indus. Policy & Promotion, Ministry of Commerce & Industry, Enhancement of Foreign Direct Investment Ceiling from 49% to 74% in Telecom Sector, File No. 9(1)/2002-FC (Jan. 1, 2007), *available at* http://siadipp.nic.in/policy/changes/pn1_2007.pdf.

42. *See* Ministry of Communications & Information Technology, FDI Policy in Telecom, *available at* http://www.dot.gov.in/osp/Investment%20Policy/FDI%20policy.htm.

In the agricultural sector, FDI up to 100 percent is automatically permitted in floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aquaculture, cultivation of vegetables and mushrooms under controlled conditions, and services related to agro and allied sectors. FDI up to 100 percent, with prior government, approval is also permitted in tea plantations, subject to a set-aside of 26 percent equity in favor of an Indian partner within five years, and requires prior approval of the relevant Indian state government concerned in case of any future land use change. The Indian government also approved the creation of the Delhi-Mumbai Industrial Corridor (DMIC), which envisages development of investment regions and industrial areas on the 1,483 kilometers Dedicated Freight Corridor (DFC) between Delhi and Mumbai, which offers high-speed connectivity for High Axle Load Wagons.[43]

The government also formulated the National Maritime Development Program (NMDP), which involves creation of berth/terminals at major national ports, enhancement of railroad connectivity between the ports and the hinterland and other associated projects. The estimated cost of the project is approximately $25 billion, and private investment is sought in commercially viable activities relating to the project.[44] In April 2007, the Indian government launched the North Eastern Industrial and Investment Promotion Policy, which aims at attracting investment for development of North-Eastern states in India. The Policy offers attractive tax benefits to investors in addition to offering up to 97 percent finance for projects under the policy.[45]

India also concluded three Bilateral Investment Promotion and Protection (BIPP) Agreements with Greece, Mexico, and Iceland in 2007. India has already concluded similar agreements with over sixty-three countries, with the goal of increasing and protecting bilateral investment flow.[46]

The Airports Economic Regulatory Authority Bill was introduced in Parliament in 2007. The bill aims to create the conditions for healthy competition amongst all major airports in the country so as to encourage investment in airport facilities.[47] The Indian Parliament also passed the Competition (Amendment) Bill of 2007, which replaces the Monopolies and Restrictive Trade Practices Commission (MRTPC) with the Competition Commission of India. The Commission will now act as an expert body in an advisory capacity and also function as a market regulator with respect to anti-competitive practices.

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43. *See* Ministry of Commerce & Indus., Dept. of Indus Policy & Promotion, Request for Proposal for Undertaking Consultancy to Prepare Concept Paper on the Project "Delhi Mumbai Industrial Corridor," File No. 11(3)/2006-IP (Feb. 21, 2007), *available at* http://dipp.nic.in/tenders/concept_paper_rfp_21feb2007.pdf.

44. Comm. on Infrastructure, Ports, http://www.infrastructure.gov.in/port.htm.

45. Memorandum from Ministry of Commerce & Indus., Dept. of Indus. Policy & Promotion, North East Industrial & Investment & Promotion Policy (NEIIPP), File No. 10(3)/2007-DBA-II/NER (Apr. 1, 2007), *available at* http://dipp.nic.in/incentive/NEIIPP_2007.pdf.

46. Nat'l Portal of India, Bilateral Inv. Promotion & Prot. Agreement (BIPA) (providing a complete list of countries with which India has signed the BIPA), *available at* http://india.gov.in/business/doing_business/bipa.php (last visited Apr. 12, 2008).

47. The Airports Econ. Regulatory Auth of India, Bill No.72 of 2007, *available at* http://rajyasabha.nic.in/legislative/amendbills/transport/Airport_Regulatory.pdf.

The MRTPC will be abolished two years after the constitution of Competition Commission.[48]

The Indian government is also consulting with the legal community about a proposal to allow foreign law firms to set up offices in India.[49] The foreign firms would operate under the limited liability partnership (LLP) model. The proposed LLP bill would allow foreign nationals to enter into limited liability partnerships, provided at least one partner is an Indian resident.

V. Japan*

In 2007, the financial services industry began to feel the full brunt of the sweeping disclosure requirements imposed by Japan's Financial Instruments and Exchange Law (FIEL),[50] as most of the 2006 laws' provisions took effect.[51] Japan's Diet adopted the FIEL on June 14, 2006, to create a safer and more transparent investing environment and to address a multitude of other regulatory problems that were seen as impeding Japan's development of a robust market for innovative financial products. FIEL broadly revises the text of the 1940s-era Securities and Exchange Law (SEL),[52] consolidating its amended text with a number of other related, ancillary statutes—four of which are now abolished.[53] The legislation effectively replaces the SEL, changing its name to the "Financial Instruments and Exchange Law." In all, the new legislation amends eighty-nine different laws—portions of which are being consolidated into the new FIEL.[54]

48. *See generally* M.R. Madhavan, Parliament Session Alert: Budget Session Part II—Apr. 26 to May 22, 2007, May 4, 2007, at 2, *available at* http://www.prsindia.org/docs/session_summary/1179491836_1178272276_Parliament_Session_Alert__Part2_Budget_2007.pdf.

49. Malar Velaigam, *Indian Gov't Says "Yes" to Foreign Law Firms*, Sept. 25, 2007, *available at* http://www.thelawyer.com/cgi-bin/item.cgi?id=129056&d=415&h=417&f=416.

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50. Kinyu shonin toriniko Financial Instruments and Exchange Law, Law No. 2 of 1948 (amended in 2006), *translated in* 6.1 EHS BULL. SER. no. 6600 MA (2006) [hereinafter FIEL]. The FIEL, which broadly revises the text of Japan's 1948 Securities and Exchange Law, was adopted along with the Coordination Law for Amending the Securities and Exchange Law and other Financial Laws, Law No. 66 of 2006. Hereinafter, all references to the FIEL will refer to both the FIEL and its companion Coordination Law. *See* Financial Services Agency, Japan, New Legislative Framework for Investor Protection—The Financial Instruments and Exchange Law 3 (Oct. 2006), *available at* http://www.fsa.go.jp/en/policy/fiel/20061010.pdf [hereinafter FSA Description].

51. The various provisions of the FIEL have different effective dates extending from July 4, 2006, to as late as fiscal years beginning on or after April 1, 2008. As the various provisions are discussed below, the respective effective dates will be noted.

52. Shokentorihiki Ho [Securities and Exchange Law], Law No. 25 of 1948, as amended [hereinafter SEL].

53. *See* FIEL, *supra* note 50, at 3. When the FIEL was enacted, the following four statutes were abolished and consolidated into the FIEL: the Financial Futures Trading Law, the Law Concerning the Regulation of Investment Advisory Services Relating to Securities, the Law Concerning Foreign Securities Firms, and the Law Concerning the Regulation of Mortgage Business.

54. *See id.*

A. Redefining "Security" to Integrate a Convoluted Regulatory Structure

Many of the regulatory problems, including inadequate disclosures, stemmed from the narrow and rigid definitions of "security" and "security derivative" under the SEL, which the FIEL replaces. By taking a principles-based approach to descriptions of covered securities, the new FIEL greatly expands the scope of the government's regulatory power and solves many of the inherent conflicts that arose under Article 65 of the SEL. By broadening the definitions of "security" and "derivative transaction," the new law covers not only government and corporate bonds, stocks, investment trusts, and securities derivatives (*i.e.*, the existing SEL categories) but also a much larger class of derivative transactions, including, for instance, weather and credit derivatives, currency swaps, interest rate swaps, and a host of other instruments whose value is linked to some combination or range of indexes and assets.[55]

The new definition of "security" includes any interest in a "collective investment scheme"—a catch-all category that is defined expansively,[56] which is and will reach many types of commodity and real estate funds as well as investments that may be invented in the future. Because of these comprehensive definitions, a far greater number of securities, derivatives, and financial instruments are likely to come within the purview of the new FIEL as compared to its predecessor statute, the SEL.

Once it is determined that a product has a security-like feature,[57] it falls within the purview of the FIEL and is subject to a number of broad provisions. Among other things, the FIEL imposes stringent (and highly controversial) disclosure requirements for listed companies and funds that market securities. Examples of such are more detailed tender offer rules, including a mandatory bid provision, tougher penalties for market abuse and insider trading, limits on takeover defenses, and more flexible rules for conducting a financial business, with the duty of care and level of disclosure made dependent on the business acumen and position of the relevant customer.

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55. *See* FIEL, *supra* note 50, art. 2, ¶¶ 20-25.

56. *See id.* "Collective investment schemes" are treated as securities under the new FIEL. More specifically, FIEL provides that rights concerning any scheme that:

> (1) collects capital or contribution in monetary or other similar form from two or more persons;
>
> (2) conducts business or undertakes investments using the money, and
>
> (3) distributes profits or properties to investors from the business or investments (*i.e.*, collective investment scheme) are deemed to be and treated comprehensively as securities [for purposes of the FIEL], regardless of the legal feature of the scheme; such as contracts for partnerships based on the Civil Law, secret partnerships based on the Commercial Law, limited investment partnerships, limited liability partnerships, or any other form of contracts (but excluding cases where all investors are involved in the business, etc.).

See id.

57. Thus, straight bank deposits and plain vanilla insurance are not regulated by the new law because they do not have security-like features that could cause their value to drop below par.

B. Increased Penalties for Securities Fraud and Insider Trading

The FIEL imposes more stringent civil and criminal penalties than the former SEL for securities fraud, insider trading, and certain types of market manipulation,[58] including *misegyoku*—a deceptive practice whereby dummy orders are placed to intentionally create a false impression of active trading but are then later cancelled just prior to completion of the transaction.[59] The tougher sanctions were promulgated in the wake of a spate of well publicized securities and accounting fraud scandals, such as the spectacular rise and fall of Livedoor Corporation (an internet start-up company that attempted a hostile takeover of the old-line media conglomerate, Fuji Television Network, without ever making a tender offer)[60] and the insider trading case involving the high profile, free-market and shareholder activist, Yoshiaki Murakami—an alleged scandal that forced the Murakami Fund to liquidate in December 2006 after nearly seven years of operation.[61]

C. New Tender Offer Rules

The rules governing the timing and disclosure of corporate takeover bids (TOBs), including the target board's countervailing efforts, are substantially revised and expanded by the FIEL. Under the new rules imposed by the FIEL, the requirement of making a formal TOB may be triggered either by traditional purchases in the stock market or by so-called "off market purchases"—acquisitions made off the trading floor and after the markets have closed.[62] The FIEL requires a potential acquirer to conduct a TOB when: (1) greater than 5 percent of a target's outstanding shares are acquired via off-market trades, and (2) the acquirer's purchased stake exceeds 10 percent of the target's stock when combined with the acquirer's prior holdings that were purchased through the traditional market. For purposes of this rule, all acquisitions within a three-month period are treated as a

58. *See* FSA Description, *supra* note 50, at 17. For individuals, the FIEL raises the penalties for market manipulation (including the spreading of rumors and various deceptive practices) to ten years in prison and/or a fine of 10 million yen, up from the SEL's previous maximums of five years imprisonment and/or 5 million yen. FIEL, *supra* note 50, art. 197, ¶ 1. For corporations submitting false registration statements regarding material information, the FIEL increases the penalty to a maximum fine of 700 million yen from the previous SEL maximum of 500 million yen. *Id.* art. 207, ¶ 1-1. If a corporation fails to submit any registration statement, the FIEL raises the maximum fine to 500 million yen from the previous maximum of 300 million yen. *Id.* art. 197-2. For insider trading, the maximum penalties are increased to five years in prison and/or a fine of 5 million yen, from the SEL's previous maximums of three years in prison and/or a fine of 3 million yen. *Id.* art. 207, ¶ 1-2.

59. *See* FSA Description, *supra* note 50, at 17. FIEL, *supra* note 50, art. 174, ¶ 1, art. 159 ¶¶ 2-1, 3. The SEL did not impose explicit penalties for *misegyoku*, and this type of deceptive market practice often went unpunished.

60. *See* Pamela A. Fuller et al., *Int'l Mergers & Acquisitions*, 40 Int'l Law. 311, 325-27 (2006) (describing Livedoor's attempted takeover of Fuji and its likely impact on Japanese securities and accounting regulations).

61. *See* Mariko Kodaki, *Analysis: Murakami had Positive, Negative Impact on Capital Market*, Nikkei Weekly, July 20, 2007.

62. FIEL, *supra* note 50, art. 27-2, ¶¶ 1-4, 1-5; *see* Fuller, *supra* note 60, at 311. The FIEL's TOB rules were made applicable to off-market purchases in direct response to the seeming ease with which Livedoor Corporation was able to acquire a controlling interest in NBS electronically after the trading floors had closed, without ever launching a tender offer. This formerly unregulated takeover technique engendered panic by Japanese firms and stockholders, prompting the rapid adoption of takeover defenses in the wake of the Livedoor saga. For a brief overview of Livedoor's hostile takeover of Fuji, and its possible legacy for securities regulation in Japan, *see supra* note 56; Fuller, *supra* note 60, at 325-27.

single acquisition. The requisite tender offer must be for at least one-third of the target's outstanding stock.[63]

To ensure that minority shareholders have an opportunity to sell their stakes in a successful tender offer, the FIEL imposes a mandatory bid rule. Once an acquirer secures more than two-thirds of a target's stock, it must offer to buy out the remaining holdings of those who participated in the original TOB.[64] The mandatory bid rule is aimed at protecting minority shareholders from unfair two-tier bids, but it can greatly increase the total price of a corporate takeover. To prevent a bidder from being put in an unreasonable position, the new rules allow a bidder to lower the price of the bid if the target's management launches a poison pill, diluting the value of the bidder's holdings.[65] The FIEL also contains more flexible rules allowing the bidder to withdraw a bid in the face of insurmountable takeover defenses[66] and delineates the conditions under which a target's board is required to issue an objective opinion on the merits of any TOB (assuming that is even possible given Japanese boards' notorious dearth of independent directors). Finally, the FIEL gives the targeted company an opportunity to extend the bidding period and to engage in a question and answer session with the bidder.[67]

D. Stringent Disclosure Rules

The FIEL substantially augments the quarterly disclosure requirements for large shareholders—new rules that have been heavily criticized as too burdensome and potentially paralyzing.[68] Under the SEL, the reporting time frame was three months. The FIEL imposes a two-week reporting frame with the goal of giving fair warning to a potential target company that a fund may be trying to acquire a controlling interest.[69] Critics of the

63. FIEL, *supra* note 50, art. 27-2, ¶¶ 1-4, 1-5. This provision essentially closes a large loophole in the SEL that was exploited by a number of acquirers besides Livedoor. Under the old SEL, for example, shareholder activist Yoshiaki Murakami was able to buy 10.5 billion yen of stock in Hanshin Electric Railroad Corporation through off-market purchases of convertible bonds without ever launching a tender offer. The Murakami Fund then boosted its stake to greater than 45 percent through market purchases. If the FIEL had applied and Murakami's company had acquired greater than 5 percent through off-market purchases, the new rules would have required it to launch a TOB.

64. FIEL, *supra* note 50, art. 27-13, ¶4.

65. *Id.* art. 27-11, ¶ 1.

66. *Id.* art. 27-6, ¶ 1-1.

67. *Id.* art. 27-10, ¶¶ 1, 2, 11; *see Steel Partners Japan Strategic Fund* v. *Bull Dog Sauce K.K.*, Koto Saibansho (Tokyo High Ct., July 9, 2007), *available in Japanese at* http://www.courts.go.jp/hanrei/pdf/20070718104214.pdf; *see also* Fuller, *supra* note 60, at 311. But query whether the FIEL clearly circumscribes the target board's power to demand a Q&A session with the bidder (perhaps exaggerating the importance of the Q&A session), given the facts of the 2007 lawsuit in which U.S. investment fund Steel Partners filed an injunction to block the exercise of a poison pill by Bull Dog Sauce, Ltd.—the target in Steel Partner's hostile bid to acquire control. Denying Steel Partners' request for an injunction, the Tokyo High Court found that Steel Partners was an "abusive bidder," in part, because it had failed to answer all of the Bull Dog Board's questions. One open question that was not answered in the Bull Dog judicial opinions is the degree to which a bidder should be required to reveal its future business plans, which could tip off competitors to proprietary information like investment strategies.

68. *See* FIEL, *supra* note 50, art. 27-26, ¶¶ 1-3. Specifically, the FIEL provides that once an institutional shareholder's ownership of a company exceeds 5 percent of all that company's outstanding shares, the shareholder must report its ownership within five business days and then "roughly two weeks."

69. *See id.*; *see* FIEL, *supra* note 50, at 15. In early 2006, the Murakami Fund (*i.e.*, M&A Consulting, Inc.) obtained more than one-third of Hanshin Electric Railway Corporation without launching a tender offer,

new provision contend this shortened time frame is overly protective of target corporations and totally unrealistic—an over-reaction to a few high-profile takeover attempts that will unfairly force institutions to reveal proprietary information like investment strategies, generate unnecessary paperwork, discourage share purchases by foreign funds,[70] and ultimately weaken the performance of big mutual funds.[71]

Other onerous disclosure provisions of the FIEL took effect on September 30, 2007, requiring banks, securities firms, and insurance companies that market financial products to thoroughly explain to their ordinary, non-institutional investors all the inherent risks of the products, including the associated fees and other matters.[72]

E. J-SOX Internal Control Reports

For fiscal years beginning on or after April 1, 2008, the FIEL will require all public companies and their significant affiliates that are listed on Japanese stock exchanges to file quarterly reports with the Ministry of Finance (MOF), including, for the first time, thorough "internal control reports" substantiating the validity of their financial reporting.[73] The sections of the FIEL requiring internal control reporting and the implementing of ministerial ordinances promulgated by the FSA are popularly known as "J-SOX"—an unofficial term that refers to the Japanese requirements similar to several sections of the U.S. Sarbanes-Oxley Act of 2002 (SOX), the U.S. accounting and auditing legislation applicable to publicly held corporations adopted in the wake of the Enron scandal.[74]

While the FIEL contains a much broader range of provisions than SOX, the specific requirements of the J-SOX portion of the FIEL are similar in substance to Section 302 (management certification) and Section 404 (management evaluation and report on internal controls) of the SOX legislation. Unlike SOX, J-SOX is limited to internal controls affecting financial reporting, but the J-SOX definition of "financial reports" is comparatively broad. It includes financial statements and footnotes and certain other financial-

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claiming that the purchases were for investment purposes only. When the Murakami Fund's holdings exceeded 45 percent, however, Murakami was able to exert pressure to replace half of Hanshin's board of directors. Under the FIEL, if the acquiring institutional investor's objective is to replace the target's senior management or alter its board's composition, the disclosure time frame is just five business days.

70. *See* Yuka Hayashi, *Japan Regulators Aim to Tighten Disclosure Rules—Mutual Find Firms Bristle at Proposed Timeframe on Reporting of 5% Stakes*, WALL ST. J., Feb. 21, 2006, at C11. The new disclosure rule for large institutional shareholders is much stricter than those of many other developed nations. For example, under U.S. federal securities law, institutions are required to report their 5 percent holdings just once per year, and in Europe, regular reporting requirements are triggered only for stakes amounting to 10 percent of a listed company. If the new two-week disclosure requirement triggers any decline in Japanese equity investments by foreign funds, it could have a dramatic effect on Japan's economy. In 2005, foreign investors accounted for 45.1 percent of all share trading (by value) on Japan's top three stock exchanges.

71. *See* FIEL, *supra* note 50, art. 18. The FIEL requires that the new two-week reporting rule take effect no later than eighteen months following the FIEL's enactment, which was Dec. 13, 2007.

72. *See Stricter Law Causing Sharp Drop in New Investment Trusts*, NIKKEI WEEKLY, Oct. 13, 2007.

73. FIEL, *supra* note 50, arts. 24-4-4, 24-4-2, 24-4-8, 193-2. The new quarterly reporting system is effective for fiscal years beginning on or after April 1, 2008

74. The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amendments in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

related disclosures in public reports, such as financial highlights, shareholders, and the status of stock issued.[75]

On December 8, 2005, the FSA issued a major regulation entitled the "Evaluation and Auditing Standards for Internal Control of Financial Reports" (the "Evaluation and Audit Standards"),[76] followed by a separate exposure draft on November 21, 2006, titled "Implementation Standards,"[77] which provide clarification. Both sets of Standards were finalized by the FSA in 2007, and delineate many of the J-SOX rules. For purposes of the Evaluation and Audit Standards, "internal control" is generally defined as "a process that is carried out by all members of the company, in order to fulfil four corporate objectives: (1) effectiveness and efficiency of operations; (2) reliability of financial reports; (3) compliance with laws and regulations relating to business activities; and (4) preservation of assets." More specifically, proper internal control consists of six elements: (1) controlling the environment; (2) risk assessments and responses; (3) controlling activities; (4) information and communication; (5) monitoring; and (6) response to information technology.[78]

Starting with fiscal years beginning on or after April 1, 2008, the new J-SOX internal control reporting rules will apply to all public companies, domestic and foreign, listed on a Japanese stock exchange, including their significant subsidiaries and affiliates. Because most of these approximately 3,800 companies have a March 31 fiscal-year end, their first filing of a management evaluation report on internal controls will be for the fiscal year ending on March 31, 2009. J-SOX will require these listed companies to evaluate their internal controls on a consolidated basis, something few Japanese companies have done. Moreover, as compared to U.S. companies, many Japanese companies do not have a long history of internal auditing.

VI. The People's Republic of China*

On May 29, 2007, the State Administration of Foreign Exchange of China (SAFE) issued new implementing guidelines related to foreign exchange controls under an official notice known as "Notice 106,"[79] which requires the owners of Chinese companies to obtain SAFE's approval before establishing any offshore holding company structure for foreign financing, as well as for subsequent acquisition matters in China. Notice 106 clarifies SAFE's earlier "Circular 75"[80] and also addresses the foreign exchange requirements that are set forth in China's 2006 M&A Regulations.[81]

75. *See* Subcomm. of Internal Controls of the Bus. Accounting Council, Fin, Ser. Agency, *Evaluation and Auditing Standards for Internal Control for Financial Reports—Basic Framework of Internal Control (Part I)*, Dec. 8, 2005 [hereinafter Evaluation and Audit Standards].

76. *See id.*

77. Subcomm. of Internal Controls of the Bus. Accounting Council, Fin. Serv. Agency, *Implementation Standards Exposure Draft*, Nov. 21, 2006.

78. Evaluation and Audit Standards, *supra* note 75.

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79. Hui Zong Fa [2007] No. 106, *Operational Guidelines for the Circular on Relevant Issues with Respect to the Round-Trip Investment of Funds Raised by Domestic Residents Through Offshore Special Purpose Companies.*

80. Hui Zong Fa [2005] No. 75, *Notice of the State Administration of Foreign Exchange on Relevant Issues Concerning Foreign Exchange Administration for Domestic Residents to Engage in Financing and in Return Investment via Overseas Special Purpose Companies.*

81. In September 2006, SAFE, China's Ministry of Commerce and four other Chinese government agencies promulgated a comprehensive new set of regulations (2006 M&A Regulations) dealing with all foreign

Notice 106 imposes new compliance requirements on foreign investors and Chinese individuals and companies engaged in "round-trip" investment transactions. Under the SAFE rules, "round-trip" investments refer to transactions whereby Chinese domestic residents invest in, control, or establish an offshore special purpose company (SPV) for the purpose of obtaining foreign financing for an "onshore" company or assets in China. The onshore company and assets in China are generally controlled by the Chinese domestic residents who set up the offshore SPV. Notice 106 provides a detailed roadmap of the approval and registration requirements for round-trip investment transactions, including: (i) establishing the offshore SPV; (ii) inserting assets into the offshore SPV; (iii) changing or restructuring the offshore SPV; and (iv) establishing, acquiring, or investing in the Chinese onshore target company through the offshore SPV.

Notice 106 expands on earlier registration requirements by establishing an obligation on Chinese residents to register with the local SAFE branch before establishing or acquiring control over an offshore SPV for the purpose of round-trip investments. Among other things, Notice 106:

- expands the definition of "domestic resident natural persons" who must register offshore SPV financings;
- adds new categories of documentation required for registration, including the financial reports of the Chinese onshore target company for the previous three years;
- adds requirements relating to the source of the Chinese resident's funds used to establish or acquire the offshore SPV;
- covers the use of existing offshore SPVs for offshore financings;
- covers situations in which an offshore SPV establishes a new subsidiary in China or acquires an unrelated company or unrelated assets in China;
- imposes new preconditions for registrations, including a new requirement that the Chinese onshore target company and the offshore SPV must have a common management and shareholding structure in order to obtain registration; and
- makes the Chinese onshore target company responsible for the accuracy of certain documents that must be filed in connection with any offshore SPV financing registration, including notably, the business plan which describes the overseas financing and the use of proceeds.

In addition to fines and penalties, failure to comply with these requirements could result in the offshore SPV's affiliates being prevented from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to the offshore SPV, or from engaging in other transfers of funds into or out of China.

In light of the financial penalties and other risks related to non-compliance with the SAFE rules, foreign investors engaged in Chinese round-trip investment transactions should make it a due diligence priority to confirm that the offshore SPVs they intend to

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M&A activity in China, as well as with restructurings leading to offshore offerings and other international financings. The full title of the 2006 M & A Regulations is "Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" and was promulgated jointly by the Ministry of Commerce, State-Owned Assets Supervision and Administration Commission of the State Council, State Administration of Taxation, State Administration for Industry and Commerce, China Securities Regulatory Commission, and State Administration of Foreign Exchange on August 8, 2006, and effective as of September 8, 2006.

finance have complied with all SAFE requirements and have successfully obtained the necessary SAFE registrations.

VII. Peru*

A stable economic and political environment has continued to attract cross-border investment to Peru in different areas of the economy, including the traditional natural resource industries, the resurgent textile business, and the booming agribusiness activities. This trend has been strengthened with the signing of a free trade agreement with the United States,[82] which is expected to be approved by the U.S. Senate by the end of 2007.

The Ministry of Transportation and Communications (MTC) approved[83] guidelines (the "Guidelines") aimed at promoting the development of the Peruvian telecommunications market through the enhancement of competition, the improvement of infrastructure, and the expansion of telecommunications services to rural areas and other areas of social interest. The Guidelines set forth a series of goals to be achieved by the year 2011 as a way of monitoring the development of private investment in the telecommunications market, including: (i) attaining telecom density of twelve fixed telephony lines for every 100 citizens and sixty mobile telephony lines for every 100 citizens; (ii) introducing mobile and fixed telephony services in all areas in where these services are not currently available; (iii) increasing access to the internet and enhancing the use of broadband with a goal of a million connections; (iv) gaining access to those services and technology needed to pioneer the market of the region; and (v) encouraging the convergence of telecommunications services and the digitalization of the networks.[84]

On the tax front, significant amendments to the treatment of capital gains arising from trading in securities were introduced and become effective on January 1, 2009.[85]. Thus, capital gains earned by individuals will be calculated separately from other sources of taxable income, at the rate of 5 percent while taxation on dividends granted to natural persons will still be subject to a rate of 4.1 percent. In addition, individuals will not be able to offset losses related to a specific source with income obtained from other sources. Interest and gains earned from debt instruments issued on or after March 11, 2007, will only be exempted from income tax until the end of fiscal year 2008. Capital gains arising from debt instruments issued before 2009 will still benefit from the exemption. The amendments also introduce changes in respect of the tax rates that apply to income obtained by non-domiciled taxpayers.

Further amendments to the Income Tax Law[86] allow individuals or entities involved in a joint venture lasting for no longer than three years to choose to keep independent accounting records or to obtain a taxpayer identification number and thus be regarded as an

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82. Approved in June 2006 by the Peruvian Congress by means of Legislative Resolution No. 28766 and ratified through Supreme Decree No. 030-2006-RE dated June 30, 2006. A Protocol of Amendment was further approved on June 29, 2007, pursuant to Legislative Resolution No. 29054, which was ratified by Supreme Decree No. 40-2007-RE, dated July 3, 2007.

83. Supreme Decree No. 003-2007-MTC, published in the Official Gazette on Feb. 2, 2007, *available at* http://www.mtc.gob.pe/portal/comunicacion/politicas/normaslegales/DS_003_2007_MTC.pdf.

84. *Id.*

85. Legislative Decree No. 972, published in the Official Gazette on Mar. 10, 2007.

86. Legislative Decree No. 979, published in the Official Gazette on Mar. 15, 2007.

independent taxpayer. In turn, a new "VAT Early Recovery Regime"[87] allows for the refund of any VAT credit that arises in the purchase of goods and services by a taxpayer during a pre-operative phase of an undertaking or project, thus allowing pre-operative stage ventures to avoid having to wait until they start commercial activity to recover the VAT paid during the development phase.

VIII. Spain*

Spain experienced important developments affecting foreign investments in 2007, including tighter controls on investments in the energy sector and a new competition law.

A. Authorization Requirements for Investments in Energy Companies

New regulations affecting the hydrocarbons sector[88] make, under certain circumstances, the acquisition of shares in energy companies by companies that carry out regulated activities subject to the authorization of the *Comisión Nacional de Energía* (CNE).[89] This authorization is also required in the event that the acquisition involves assets necessary to develop energy activities. The CNE has the power to authorize or reject the investment or to impose conditions. Moreover, the authorization of the CNE must be requested before the acquisition is executed. If the acquisition is to be done by means of a takeover bid, the acquirer must obtain the CNE's authorization before he gets the corresponding authorization of the offer by the Spanish securities regulator.

B. New Law for the Defense of Competition

Another relevant development is the enactment of the new Law for the Defense of Competition.[90] Among other things, this law regulates the substantive aspects of the "control of economic concentrations" and introduces novelties regarding three key issues. First, the law explains and broadens the concept of concentration for the purposes of control, establishing a simplified procedure for operations that have lesser effects on competition. Second, it weakens the notification obligation and the prohibition against executing any concentration until clearance from the administration has been obtained. Finally, the law reinforces the participation of the *Comisión Nacional de Competencia* (CNC)[91] and limits the role of the Spanish government in the "control of concentrations,"

87. Legislative Decree No. 973, published in the Official Gazette on Mar. 10, 2007.

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88. *See* Resolución de 17 febrero de 2006, de la Dirección General de Calidad y Evaluación Ambiental (B.O.E. 2006/3521), *available at* www.boe.es/boe/dias/2006/02/28/pdfs/A08253-08280.pdf; amending Ley 34/1998, de 7 de octubre, del sector de hidrocarburos (B.O.E. 1998/23284), *available at* www.boe.es/boe/dias/1998/10/08/pdfs/A33517-33549.pdf.

89. Ley 34/1998, de 7 de octubre, del sector de hidrocarburos (B.O.E. 1998/23284), *available at* www.boe.es/boe/dias/1998/10/08/pdfs/A33517-33549.pdf. The CNE is the Spanish body that regulates the energy systems.

90. *See* Orden ECI/1977/2007, de 25 de junio, (B.O.E. 2007/13006), *available at* www.boe.es/boe/dias/2007/07/04/pdfs/A28950-28950.pdf.

91. *See id.* The CNC, created by Law 15/2007, incorporates the former *Servicio de Defensa de la Competencia* and *Tribunal de Defensa de la Competencia*, and is the competent authority for the instruction and the resolution

and specifies the substantive evaluation criteria that must guide the decisions of both organizations.

As noted above, one of the most important changes is the weakening of the obligation to suspend the effects of any concentration until clearance from the administration is obtained. Although the new law maintains the compulsory notification system and the obligation to suspend the transactions, the new law now foresees the possibility of lifting the obligation to suspend the execution of the concentration at any moment during the process. In addition, if the transaction is made in the context of a public company takeover, the suspension obligation only affects the exercise of the voting rights carried by the securities and does not affect the possibility of launching the bid, as long as the notification terms set out in the new law are fulfilled.

of procedure for the control of concentrations as well as, in general, for the preservation, guarantee, and promotion of effective competition in the Spanish markets.