International Financial Products and Services

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I. Carbon Credits in Brazil*

On July 21, 2009, the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários*, or the CVM) informed the market[1] that Certified Emission Reductions, or CERs (also more commonly known as carbon credits) are not derivatives or assets to which investment funds are linked (*títulos de investimento coletivo*), and consequently shall not be treated as securities (*valores mobiliários*) or regulated as such by the CVM. The position of the Brazilian regulator with respect to CERs is that such instruments are deemed to be assets whose sale can occur for investment purposes or to meet emission-reduction goals. Therefore, CERs currently are not subject to the requirements of Law No. 6.385, of December 7, 1976, as amended by Law No. 10.303, of October 31, 2001 (the Brazilian Securities Law, or BSL),[2] which governs the Brazilian securities market.

For the purposes of the BSL, the term securities[3] comprises the following: (i) shares, debentures, and subscription bonuses; (ii) coupons, rights, subscription receipts, and split certificates relating to the securities indicated in item (i); (iii) certificates of deposit of securities; (iv) debentures certificates; (v) shares of mutual funds investing in securities and shares of investment clubs investing in any type of assets; (vi) commercial paper; (vii) futures, options, and other derivatives agreements whose underlying assets are securities; (viii) other derivatives agreements regardless of the respective underlying asset class; and (ix) when publicly offered, any other collective investment instrument or agreement that creates the right of participation in profits or remuneration, including as a result of the

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1. Press Release, CVM, CVM Communicate Their Understanding of Carbon Credits (July 21, 2009), *available at* http://www.cvm.gov.br.

2. Lei No. 10.303, de 31 de outubro de 2001, D.O.U. de 09.12.1976. (Brazil), *available at* http://www.planalto.gov.br.

3. Lei No. 10.303 de 31 de outubro de 2001, art. 2.

rendering of services, and whose profits derive from the efforts of the entrepreneur or from the efforts of third parties. All securities are subject to the supervision of and control by the CVM. Federal, state, or municipal government bonds and negotiable instruments guaranteed by a financial institution (other than debentures) are not deemed to be securities for this purpose[4] and are subject to the supervision and control of the Central Bank of Brazil (*Banco Central do Brasil*, or *Bacen*) and not of the CVM.

CERs are instruments issued by the Clean Development Mechanism (CDM) Executive Board, a body created under the United Nations Framework Convention on Climate Change. This body supervises the CDM or an instrument that represents the voluntary reduction of emissions of a certain quantity of greenhouse gases (GHGs). One CER is equal to one ton of carbon. CDMs are based on the principle that companies based in emerging markets can voluntary reduce their emission of GHGs, or alternatively increase the sequestration of GHGs, through the trading of carbon credits in a global carbon marketplace. Transactions can occur with industrialized countries (or with companies in such countries) in need of credits to meet their emission reduction targets in accordance with the Kyoto Protocol. This flexible mechanism, therefore, enables countries to reduce their global GHG emissions while also providing an attractive alternative method to foster sustainable development in emerging market countries. The CDM is the only such mechanism available in Brazil.

Some carbon credit products related to CERs, such as certificates, synthetic instruments, or derivatives, depending on their specific characteristics, might be considered securities by the CVM. Each such product needs to be analyzed on a case-by-case basis. If the CVM considers such a product a security, it will be subject to the BSL.

Brazilian investment funds are duly authorized to acquire CERs or other carbon credit certificates or derivatives in accordance with rules and regulations that govern these funds.[5] Among authorized financial assets, investment funds can invest in numerous products such as warrants, contracts for the forward purchase or delivery of credits, or any other relevant transaction or product, provided the transaction or product is expressly authorized by regulations applicable to such funds.[6]

CERs are considered to be financial assets issued outside Brazil and their acquisition by investment funds is determined by the rules and regulations applicable to such funds. Furthermore, CERs acquired by or entered into by a fund must be listed on a relevant stock, commodities, or futures exchange, or must otherwise be registered in their home

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4. Lei No. 10.303 de 31 de outubro de 2001, art. 2, § 1.

5. The current regulations on the incorporation, administration, operation, and disclosure of information with respect to Brazilian investment funds have been approved by Instrucao CVM No. 409, de 18 de Agosto de 2004, D.O.U. de 24.08.2004. (Braz.) (amended by: (i) Instrucao CVM No. 411, de 26 de Novembro de 2004, D.O.U. de 01.12.2004. (Braz.); (ii) Instrucao CVM No. 413, de 13 de Dezembro de 2004, 2004, D.O.U. de 31.12.2004. (Braz.); (iii) Instrucao CVM No. 450, de 30 de marco de 2007, D.O.U. de 03.04.2007. (Braz.); and (iv) Instrucao CVM No. 456, de 18 de agosto de 2004, D.O.U. de 26.06.2007). (Braz.). The updated and consolidated text of these regulations are *available at* http://www.cvm.org.br.

6. *See* Instrucao CVM No. 409 of de 18 de agosto de 2004, art. 2, item VIII.

country of issuance and must be supervised by recognized local authorities.[7] These requirements also apply to specific accounts opened in an investment fund's name.[8]

With respect to carbon credit certificates or derivatives issued in Brazil, an investment fund may invest only in financial assets that are (1) approved for trading on a major stock, futures, or commodities exchange in Brazil,[9] or (2) recorded in Brazil's relevant registration system and duly authorized by Bacen or the CVM.[10] These requirements also apply to specific accounts opened in an investment fund's name.[11]

The CVM has concluded that currently there is no need to impose specific regulations with respect to activities related to the issuance of carbon credits. If and when the need arises, the CVM will consider such specific rules governing fund-raising structures and financial products derived from carbon credits.

II. Tied Agents and the EU Passporting Regime*

Under Directive MIFID I,[12] an investment firm may carry on its business in another Member State on the basis (and within the scope) of its authorization in its home Member State. The business may be carried on either on a cross-border basis under article thirty-one of the MIFID or as a branch under article thirty-two of MIFID. Any generally permanent physical presence by an investment firm in the host Member State requires opening a branch, while remote activity (*e.g.* remote trading on a stock exchange) may be done on a cross border basis.

Both methods of providing investment services require the investment firm to follow the "passporting" procedure that starts with a notification to the home Member State regulator (or competent authority in the MIFID). When cross border services are to be provided, the regulator has one month to examine the matter, after which its approval is transmitted to the regulator of the host Member State. In the event of establishing a branch, the approval will generally be transmitted within three months. After receiving such approval, the supervisor in the host Member State has two months to inform the investment firm of any particular requirements that should be followed when carrying business in the host Member State.

In addition, the MIFID uses the concept of "tied agents" that an investment firm may use to promote its services and collect orders. A tied agent (any natural or legal person) may act on behalf of only one investment firm. In relations with clients and regulators,

7. Instrucao CVM No. 409 of de 18 de agosto de 2004, art. 2, § 5. (Braz.) (paragraph 5 has been added by Instrucao CVM No. 450 and amended by Instrucao CVM No. 465).

8. Instrucao CVM No. 409 of de 18 de agosto de 2004, art. 2, § 8. (Braz.) (paragraph 8 has also been added by Instrucao CVM No. 450).

9. In the case of Brazil, the relevant stock, commodity and futures exchange is BM&FBOVESPA S.A.–Securities, Commodities and Futures Exchange (BM&F BOVESPA S.A.–Bolsa de Valores, Mercadorias e Futuros), a legal entity created in 2008 by the merger of two major Brazilian exchanges, the Brazilian Mercantile & Futures Exchange (BM&F) and the São Paulo Stock Exchange (Bovespa).

10. Instrucao No. 409 de 18 de agosto de 2004, art. 2, § 3 (paragraph 3 has been added by Instrucao CVM No. 450).

11. Instrucao No. 409 de 18 de agosto de 2004, art. 2, § 8 (applies to domestic financial assets).

* Section II "Tied Agents and the EU Passporting Regime" was contributed by Jacek Jonak, Jacek Jonak Kancelaria Radcy Prawnego in Warsaw, Poland.

12. Council Directive 2004/39/EC, 2004 O.J. (L 145) 1–44.

the firm shall be fully and unconditionally responsible for its agent. Tied agents must be registered with the regulator in the country of its residence (a registered seat). From the first reading of the MIFID, one may conclude that when using tied agents in another host Member State, an investment firm should be treated as if it acted on a cross-border basis. Yet this is not the case: regulators adopted an approach under which an agent is treated as part of the firm at which it works, despite an agency and not an employment relationship. The Committee of European Securities Regulators stated that if investment services are provided by a tied agent in a country where the investment firm has no existing branch, this agent is "treated as a branch presence in that country."[13] Consequently, the passporting procedure that should be applied is a longer, five-month procedure.

The activities of the tied agent are supervised by a competent authority of the home Member State. Therefore, contractual arrangements between the agent and the investment firm should ensure that not only the compliance officer of the investment firm, but also representatives of the home Member State regulatory authority who supervise the entire investment firm's business have access to all relevant data.

III. The Role of the African Development Bank*

The African Development Bank Group (the AfDB) is a multilateral finance institution affiliated with the World Bank, which furthers social and economic development in Africa and is a source for the development of financial products and services in Africa. In this sense, the AfDB serves a similar role to the Inter-American Development Bank in South and Central America and the Asian Development Bank in Asia.

A. Loans

The AfDB's financial products generally consist of loans, which include synthetic local currency, as well as syndicated loans.[14] Typically, the AfDB's standard loans are either Sovereign Guaranteed Loans (SGL) or Non-Sovereign Guaranteed Loans (NSGL). A SGL is a loan made to an African regional member country (RMC) or a public sector enterprise, supported by the full faith and credit of the RMC in which the borrower is domiciled. Multinational institutions are eligible borrowers under a SGL if they are guaranteed by a RMC (usually the RMC in which the relevant development project is located). A NSGL is a loan made to a public or private sector enterprise without the requirement of a sovereign guarantee.

B. Equity Investments

The AfDB equity investments include both direct or indirect investments as well as quasi-equity such as investments in redeemable preferred shares, subordinated loans, and

13. Eur. Comm'n, Comm. of Eur. Sec. Regulators, The Passport Under MiFID: Recommendations for the Implementation of the Directive 2004/39/EC and Statement on Practical Arrangements Regarding the Late Transposition of MiFID, item 31, CESR/07-337b (Oct. 2007).

13. Section III "The Role of the African Development Bank" was contributed by Francisca Brodrick, an ABA member admitted to the bar of Nigeria.

14. *See* Financial Products of the African Development Bank: Maximising Africa's Access to Capital 5-12, (2009), *available at* http://www.afdb op.cit.

convertible subordinated loans.[15] The AfDB seeks to be an active owner through constructive board membership in the companies in which it invests funds. It provides valuable management advice and insight. As a matter of policy, it will not seek to own more than twenty-five of the outstanding shares of a company. The AfDB divests itself of its holding through sales on a local stock exchange or to local private investors.

C. Technical Assistance

The AfDB provides technical assistance services through grants to borrowers in order to assist them on related ancillary matters. The AfDB provides these types of grants to RMCs and to the private sector in RMCs.[16]

D. Risk Management and Counter-Cyclical Products

The AfDB provides risk management products such as interest rate swaps and caps/collars, currency swaps, and commodity swaps.[17] As a result of the recent financial crisis, the AfDB added counter-cyclical products designed to meet the needs of its member countries. These products include an emergency liquidity facility as well as a trade finance initiative.[18]

IV. Developments in the Netherlands*

A. Banking Code

The Netherlands Bankers' Association (NVB) published its Banking Code[19] on September 7, 2009 in response to, and partially based on, the Dutch Advisory Committee's report of April 7, 2009 on the Future of Banks.[20] The Banking Code will enter into force as of January 1, 2010 and shall be applied on a "*comply or explain*" basis.

The Code applies to all activities in the Netherlands performed by banks granted a banking license pursuant to the Dutch Financial Supervision Act (Wet op het financieel toezicht or Wft), irrespective of whether they perform their activities in the Netherlands or in another EU member state, and irrespective of whether a branch performs those activities. Banks that are part of a group can apply parts of the Code at a group level or on a consolidated basis. In principle, the Code applies in full to all relevant entities of a banking group. In addition, it is recommended that the Code apply to all entities of Dutch incorporated banking groups operating outside of the EU and to those entities operating in the Netherlands, irrespective of their country of incorporation. It is also

15. *Id.* at 19.
16. *Id.* at 27-28.
17. *Id.* at 20-24.
18. *Id.* at 25-26.
* Section IV "Developments in the Netherlands" was contributed by Lennaert Posch and Maarten Landkroon, attorneys with Stibbe, New York.
19. Code Banken (Banking Code) Stcrt. No. 20060, Dec. 23, 2009. The English informal translation of the Banking Code is *available at* http://www.nvb.nl/scrivo/asset.php?id=291515.
20. This committee was established as a result of the 2008 financial crises. Advisory Committee to the Future of Banks in the Netherlands, Restoring Trust (2009), *available at* http://www.nvb.nl/scrivo/asset.php?id=290353.

expressly recommended that activities and branches of banks licensed in another EU member state apply the Code.

In general, the Code contains principles and recommendations related to the composition, expertise, knowledge, availability, and activities of both the supervisory board and executive board of a bank. The Code includes the following recommendations:

- The supervisory board should pay special attention to the bank's risk management. All discussions related to risk management should be prepared by a risk committee or a similar committee that has sound knowledge of the tasks assigned to it and has been appointed by the supervisory board from its ranks for this purpose.[21]
- All members of the executive board should have thorough knowledge of the financial sector in general and the banking sector in particular and should be aware of the bank's activities that affect society and the interests of all stakeholders. In that respect, each member of the executive board should be required to sign a moral and ethical conduct declaration.[22]
- The executive board–and primarily its chairman–should be responsible for adopting, implementing, monitoring, and where necessary, adjusting the bank's overall risk policy. The executive board should set out the bank's risk appetite[23] to the supervisory board for approval at least once a year. Any material changes to such risk appetite in the interim should also require the supervisory board's approval.[24]
- One or more executive board member should be responsible for the bank's risk management decisions. More than one executive board member may be responsible for this task if the relevant decision materially affects the bank's risk profile and may result in a departure from the bank's risk appetite, as approved by the supervisory board. This executive board member may not hold direct responsibility for any affected commercial areas and should operate independently from the areas for which he or she has primary risk management responsibility.[25]
- Every bank should have a product approval process in place, which should prevent products being launched or distributed in the marketplace without careful consideration of relevant risks and other factors, such as duties of care towards the bank's clients. Furthermore, risk management should include a focus on financial stability and the impact of systemic risk on the bank's risk profile.[26]
- The bank should have its own internal, independent auditor periodically exchanging information with the bank's external accountants as well as the risk and/or audit committees of the bank.[27]
- Variable compensation should be more restrictive and should be, inter alia, at least partially based on long-term goals and should take into account known risks and capital costs. In any case the supervisory board's compensation should not depend on a bank's financial results.[28]

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21. Code Banken, ¶ 2.2.1.
22. *Id.* ¶¶ 3.1.2, 3.2.3.
23. Risk appetite (in Dutch, *risicobereidheid*) refers to the amount of reasonably foreseeable risk that the bank–given its proposed activities–is prepared to accept in the pursuit of its objectives.
24. Code Banken, ¶ 4.1.
25. *Id.* ¶ 3.1.8.
26. *Id.* ¶ 4.5.
27. *Id.* ¶ 5.
28. *Id.* ¶ 2.1.7.

B. Introduction of a Mitigated, Voluntary Supervision Regime

In September 2009, the Dutch cabinet proposed to amend the Wft, pursuant to which certain investment institutions offering their participation rights only to qualified investors and to the investment institution's managers, who may opt for voluntary supervision by applying for a declaration to that effect. At present, under the Wft these investment institutions–as opposed to those institutions that offer participation rights to the general public–do not require a license and are exempt from rules on market access, prudential rules, and rules of conduct. But pursuant to their own domestic rules and regulations, certain foreign institutional investors–mainly insurance companies and pension institutions–are allowed to invest only in participation rights offered by regulated and supervised investment institutions. To enable those foreign parties to invest in the Netherlands, the Dutch cabinet made the aforementioned proposal, which is intended to enter into force as of January 1, 2010.[29]

The proposed regime is more limited in scope than the Wft, because all provisions of the Wft relating to the mandatory supervision regime will not apply to institutions applying the voluntary supervision regime. Several rules and requirements relating to expertise and reliability of the institution's management and policies, minimum equity, liquidity and notification duties, information duties, custody, and registration with the Dutch Financial Markets Authority (AFM) do apply. Rules relating to quality of information, quantity and place of management, supply, and publication of annual accounts and mandatory annual revaluation of certain assets do not apply.

The introduction of this flexible regime is intended to attract those institutional and sophisticated investors that may currently participate in funds that operate under similar regimes in other countries, such as the Luxembourg Specialized Investment Fund.

V. Developments in Switzerland*

A. Introduction

Last year's regulatory developments in Switzerland have been driven by efforts to respond to the worldwide financial crisis and its effects on the Swiss financial industry generally and on Switzerland's leading internationally active banks in particular.

B. Swiss Bank Customer Secrecy

Switzerland has been involved in on-going discussions related to global tax havens, as exemplified by the widely publicized dispute between UBS AG and the U.S. Internal Revenue Service (the IRS).[30] The matter with respect to UBS AG finally has been settled and involved a dispute with respect to information requested by the IRS related to accounts held by thousands of American citizens alleged to have engaged in tax evasion and even tax

29. Hand. Kamerstukken (2009/2010, 32 036, no. 3.) (Neth.).

* Section V "Developments in Switzerland" was contributed by Dr. Martin Liebi, attorney at Bär & Karrer AG in Zürich, Switzerland.

30. Joseph Heaven & Klaus Wille, *Swiss to Work with U.S. to Save UBS Tax Agreement*, Miami Herald, Jan. 28, 2010, http://www.miamiherald.com/2010/01/28/1449795/swiss-to-work-with-us-to-save.html.

fraud with the assistance of UBS AG.[31] Many international observers have characterized the settlement as the end of the Swiss bank customer secrecy. Although Switzerland had already agreed to comply fully with the information sharing mechanism provided for in the Organizasion for Economic Co-operation and Development (OECD) Model Tax Convention, rules pertaining to Swiss bank customer secrecy have not been abolished. Switzerland will not grant automatic information exchange pursuant to re-negotiated double taxation treaties, but will share information and mutual assistance in specific, reasonably established cases of alleged tax evasion or tax fraud.[32]

C. Collective Investment Schemes

As a result of the financial crisis, the Swiss Financial Market Authority (FINMA) has allowed for the creation of "side pockets" consisting of illiquid hedge fund investments made by Swiss Funds of Hedge Funds. FINMA's ruling on whether to allow side pockets is important for the industry because Switzerland is one of the main markets for domestic and foreign Fund of Hedge Funds products. The creation of side pockets requires an approval of FINMA. Approval will be granted if the creation is in the interest of investors and no investor rights are supposedly violated. For Funds of Hedge Funds, the downside of creating side pockets is that such action results in a prohibition against issuing new units.[33] This constraint also applies to foreign Funds of Hedge Funds licensed for public distribution in Switzerland.

The Swiss Government decided to amend the Ordinance on Collective Investment Schemes by abolishing the so-called "Swiss finish" and to make the Ordinance on Collective Investment Schemes compliant with corresponding European rules. Certain procedural requirements were abolished and the Swiss rules were made consistent with the minimum EU standard. The management of Collective Investment Schemes will ensure that relevant investments are in line with the implied investment purpose of the particular fund. FINMA also relaxed limitations related to charges of investment fees for investments in related target funds.[34]

D. Anti-Money Laundering Rules

Anti-money laundering regulation has been tightened in Switzerland by introducing new identification obligations regarding legal persons as parties to a contract. An obligation to identify the purpose and nature of the related business relationship was also introduced.[35]

31. *Id.*

32. News Circular, Swiss Tax Administration, Consent to Sharing of Information (Sept. 25, 2009), *available at* http://www.estv.admin.ch/00977/index.html?lang=en. Double taxation treaties related to enhanced mutual assistance in tax matters have been renegotiated with the USA, Qatar, Finland, Denmark, Mexico, Great Britain, Austria, Norway, Singapore, France, and Luxembourg.

33. FINMA, Side Pockets for Funds of Hedge Funds (Jan. 23, 2009), http://www.finma.ch/e/aktuell/Pages/aktuell-sidepockets-20090123.aspx.

34. FINMA, Suppression of "Swiss Finish" for Collective Investment Schemes (Jan. 28, 2009), http://www.finma.ch/e/aktuell/Pages/aktuell-abschaffung-swissfinish-20090220.aspx.

35. FINMA, New Due Diligence Under the Money Laundering Act, Which Entered into Force on 1 February 2009 (Apr. 3, 2009), http://www.finma.ch/e/aktuell/Pages/aktuell-sorgfaltspflicht-20090403.aspx.

E. Supervisory Activities of the Swiss Financial Markets Authority in the Context of the Financial Crisis

FINMA issued a report (in German) about the roots of the financial crisis and its supervisory response.[36] In this report, FINMA outlined the problems with which it was confronted and the actions it took in response. FINMA came to the conclusion that the financial crisis was in first instance a global problem due to a misinterpretation of the stability of the financial system by market participants and regulators. FINMA stated that its response was generally no better or worse than the response of regulatory authorities in other jurisdictions. The regulator criticized some of its policy responses to the financial crisis, in particular, its supervisory activities in respect of UBS AG, one of two major Swiss global banks. FINMA admitted that its staff supervising UBS AG and Credit Suisse Group did not possess sufficient skills and expertise to adequately perform their supervisory functions.[37]

One of FINMA's key findings was that the two Swiss globally active banks were well capitalized according to minimum international standards.[38] This was also true when capitalization was measured in accordance with the Value-at-Risk model, which has begun to be utilized in accordance with the Basel I and the Basel II accords.[39] The application of this model resulted in a significant underestimate of real risk exposure, because the model did not take into consideration outliers of the magnitude experienced during the financial crisis. FINMA therefore came to the conclusion that (i) the capital requirements applicable to major globally active banks must be increased; (ii) risk calculation models must be improved; (iii) a leverage ratio independent of a risk capital quota should be introduced; (iv) a countercyclical equity cushion should be introduced; and (v) the equity component of a bank's balance sheet should be made more stable.[40]

FINMA also found that the regulation of liquidity management by banks had been neglected. The financial crisis has shown that adequate liquidity management is as important as adequate capitalization. FINMA also admitted that it did not track and criticize the growth of the total balance sheet of UBS AG.[41] An enhanced focus on the growth rate of the UBS AG total balance sheet, instead of a focus on risk-adjusted assets, would have uncovered additional risks that went unheeded.

FINMA concluded the report with the finding that it seriously had underestimated both certain inherent systemic risks as well as certain company-related problems, the result of which was an inadequate regulatory response. FINMA found, however, that by the same token the de-regulatory environment that was generally pervasive would not have allowed for stricter regulatory supervision.[42] Stricter regulatory supervision would probably have been seen as overly bureaucratic and anti-commercial and would likely have lacked necessary political support to implement.

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36. FINMA, Financial Market Crisis and Financial Market Supervision (2009).
37. *Id.* at 14.
38. *Id.* at 18. The BIS Tier 1-capital quota as of June 30, 2007 was 12.3% for UBS AG and 13.0% for Credit Suisse Group.
39. *Id.* at 29.
40. *Id.* at 32-33.
41. *Id.* at 37.
42. *Id.* at 18.