

## **International Securities and Capital Markets**

JENNIFER Y. POON, DR. MANFRED KETZER, WALTER STUBER, ROBERT LANDO,  
AUDREY KRAVETS, SANDEEP PAREKH, PERRY WILDES, AYELET KRISPIN,  
PIYASENA PERERA, MARIO PIANA, JOSÉ CARRILLO, DANIEL WINTERFELDT,  
TRISH O'DONNELL, AND JENNIFER PENCE\*

The following article summarizes selected developments during 2015 in the regulation of international securities and capital markets in Austria, Brazil, Canada, Germany, India, Israel, Japan, Mexico, and the United Kingdom.

### **I. Developments in Austria**

#### **A. EUROPE'S FIRST APPLICATION OF THE EUROPEAN BANKING RECOVERY AND RESOLUTION DIRECTIVE (BRRD)<sup>1</sup>**

The mid-sized Austrian bank, Hypo Alpe-Adria-Bank International AG, was formerly owned by the Austrian province of Carinthia. The liabilities incurred by the bank were secured by a guaranty of the province (directly and via a holding entity). Prior to the obligation to fade out the guaranty, which the European Union deemed illegal state aid, the bank increasingly issued bonds and other debt instruments to fund its expansion. In

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\* Jennifer Y. Poon, CMS Cameron McKenna LLP (London) served as the committee editor. Dr. Manfred Ketzer, Hausmaninger Kletter Rechtsanwälte-Gesellschaft m.b.H. (Vienna), contributed Austria's developments. Walter Stuber, Walter Stuber Consultoria Jurídica (Sao Paulo), contributed Brazil's developments. Robert Lando, Osler, Hoskin & Harcourt (New York), contributed Canada's developments. Audrey Kravets, Kravets & Kravets (Cuxhaven), contributed Germany's developments. Sandeep Parekh, Finsec Law Advisors (Mumbai), contributed India's developments. Perry Wildes and Ayelet Krispin, Gross, Kleinhendler, Hodak, Halevy, Greenberg & Co. (Tel Aviv), contributed Israel's developments. Piyasena Perera, Anderson Mori & Tomotsune (Tokyo), contributed Japan's developments. Mario Piana and José Carrillo, Chadbourne & Parke, S.C. (Mexico City), contributed Mexico's developments. Daniel Winterfeldt, Jennifer Poon, Trish O'Donnell and Jennifer Pence, CMS Cameron McKenna LLP (London) contributed the United Kingdom's developments.

1. Directive 2014/59/EU of the European Parliament and Council of 15 May 2014 on Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms and Amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, 2014 O.J. (L 173/190).

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the course of the financial crisis, the bank ran into financial difficulties and had to be saved from insolvency by the Republic of Austria, which took over sole ownership of the bank.

In 2014, the bank was restructured into a resolution entity – HETA Asset Resolution AG (HETA). In order to curtail financial obligations, the Republic of Austria issued an Act<sup>2</sup> rendering rights of owners of junior debt instruments factually void without material compensation. Those voided rights included the timely repayment of loans. Concerned investors filed suits with Austrian courts and requested review of the Act by the Austrian Supreme Constitutional Court. With its July 3, 2015 decision, the Austrian Supreme Constitutional Court held that HaaSanG was unconstitutional because it interfered with basic constitutional rights, and it abolished the law.

In the meantime, the Republic of Austria had enacted the Austrian application of the BRRD, the Bankensanierungs- und Abwicklungsgesetz (BaSAG),<sup>3</sup> which provides, among other things, for a controlled winding down of banks.

After being informed by the management board of HETA about its potential inability to fully and orderly service all outstanding financial obligations, the Austrian Financial Market Authority (FMA) issued a decree on March 1, 2015, ordering a moratorium with respect to the majority of debt instruments, including interest, until at least May 31, 2016. Until this date, the FMA intends to review the asset quality of HETA and decide on the application and scope of the available measures. The general goal of both the BRRD and the BaSAG is to involve investors in securities issued by banks in the restructuring and winding-down process of such banks in order to ensure taxpayers' funds are not at risk. It is expected that the FMA will issue a decree ordering the “bail-in” of investors affected by the moratorium, which would lead to a reduction of the claims of these owners of debt instruments to the extent serviceable by HETA.

Hence, Austria has so far experienced two governmental acts with substantial impacts on the rights of owners of financial instruments originally issued by a bank and based on the notion of the BRRD.

It remains to be seen how this matter will unfold and whether claims by the parties involved, as to whether such conduct does or does not comply with Austrian and European legal principles, will survive potential review by competent courts.

## II. Developments in Brazil

### A. PARTICIPATION AND REMOTE VOTING IN GENERAL SHAREHOLDERS' MEETINGS IN BRAZIL

On April 4, 2015, the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários*–CVM) issued CVM Instruction No. 561 (CVM Instr. 561/2015),<sup>4</sup>

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2. BUNDESGESETZ ÜBER SANIERUNGSMAßNAHMEN FÜR DIE HYPO ALPE ADRIA BANK INTERNATIONAL AG (HAA-SANG) [THE LAW ON REHABILITATION MEASURES FOR THE HYPO ALPE ADRIA BANK INTERNATIONAL AG (HAA-SANG)] BUNDESGESETZBLATT [BGBl.] No. 51/2014 (Austria).

3. BUNDESGESETZ ÜBER DIE SANIERUNG UND ABWICKLUNG VON BANKEN (SANIERUNGS- UND ABWICKLUNGSGESETZ – BASAG) [FEDERAL LAW ON THE REORGANIZATION AND LIQUIDATION OF BANKS (RECOVERY AND RESOLUTION LAW - BASAG)] BUNDESGESETZBLATT [BGBl.] No. 98/2014 (Austria).

4. Instrução CVM No. 561, de 7 de Abril de 2015, *Diário Oficial da União* – [D.O.E.R.J.], Abril 2015 (Braz.).

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which regulates participation and remote voting in general shareholders' meetings of publicly-held corporations. CVM Instr. 561/2015 amends both CVM Instruction No. 480 of December 7, 2009,<sup>5</sup> which deals with the registry of issuers of securities admitted to trading on securities regulated markets, and CVM Instruction No. 481 of December 17, 2009,<sup>6</sup> which contains rules on information and requests of public proxy for exercise of voting rights at shareholders' meetings.

CVM Instr. 561/2015 aims to facilitate the participation of shareholders in general meetings either through a vote or through the submission of proposals, as well as to enhance the corporate governance instruments available in the Brazilian market. The facilitation of the process of voting was based on strong demand on the part of both non-resident shareholders (foreign investors) and Brazilian residents (individuals).

For this purpose, this new regulation provides for the following:

- (a) the creation of a remote voting bulletin through which shareholders may exercise their right to vote prior to the date the general meeting is held;
- (b) the possibility of inclusion of candidates and proposals of deliberation of minority shareholders in that bulletin, with due observance of certain percentages of equity interest, in order to facilitate the shareholders' participation in general meetings; and
- (c) the deadlines, procedures, and ways of sending this bulletin, which may be forwarded by the shareholder: (i) directly to the company; or (ii) to the custodian (if the shares held by the shareholder are kept at a centralized deposit) or to the book-entry agent of the shares issued by the company (if such shares are not kept at a centralized deposit).

The bulletin must be available to the shareholders up until one month before the date scheduled for the general meeting, and the company must receive the bulletin at least seven days in advance of the meeting.

Initially, the bulletin system may only be used in general meetings to vote on agenda topics, after prior presentation of proposals from shareholders, and to elect members of the Audit Committee (*Conselho Fiscal*) and, in certain cases, the Board (*Conselho de Administração*).

These cases are comprised of the following situations: (i) when the election is needed due to vacancy of most of the offices of the Board; (ii) for vacancy of the office of the Board when the member has been elected for multiple voting; or (iii) for filling the slots dedicated to a separate election as provided for in articles 141, paragraph 4, and 239 of the Law No. 6,404, of December 15, 1976 (the Brazilian Corporation Law - BCL),<sup>7</sup> as mentioned below.

In order to propose and include topics to be discussed on the agenda of the general meeting, or indicate council members, the shareholders will need to achieve certain equity percentages stipulated by CVM, which vary pursuant to capital stock tracks, depending on the size of the company, in accordance with the table indicated below.

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5. Instrução CVM No. 480, de 7 de Dezembro de 2009, *Diário Oficial da União* [D.O.E.R.J.], Dezembro 2009 (Braz.).

6. Instrução CVM No. 481, de 17 de Dezembro de 2009, *Diário Oficial da União* [D.O.E.R.J.], Dezembro 2009 (Braz.).

7. Lei No. 6.404, de Dezembro 15 de 1976, *Diário Oficial da União* [D.O.E.R.J.] de 15.12.2008 (Braz.).

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<b>Capital Stock</b>	<b>Topic</b>	<b>Council Member</b>
Up to R\$ 500 million	5%	2.5%
Above R\$ 500 million and up to R\$ 2 billion	3%	1.5%
Above R\$ 2 billion and up to R\$ 10 billion	2%	1.0%
Above R\$ 10 billion	1%	0.5%

CVM has limited the requirement of this bulletin to the general meetings because it is a new voting system that needs to be tested. For this reason, CVM cautiously decided to restrict it only to those meetings that are more predictable both in relation to the occurrence and to the matters discussed. When this new mechanism is tested and improved, CVM can then assess the extent of the remote electronic voting system to the extraordinary meetings.

With the bulletin, CVM eliminates the need for proxies and ensures that shareholders will exercise their voting rights personally. The use of the bulletin will be valid as of January 1, 2016, for companies with at least one species or class of shares listed on the Bovespa index (Ibovespa) and the Brazil 100 index (IBrX-100), and as of January 1, 2017, for all companies registered with CVM in category A and authorized by an entity that manages the regulated market represented by shares traded on the stock exchange.

### **III. Developments In Canada**

#### **A. CANADIAN “WRAPPER” REFORMS**

International securities offerings have traditionally been extended into Canada through the use of a Canadian “wrapper” around the prospectus or offering circular used in other countries. New exemptions came into effect on September 8, 2015,<sup>8</sup> and in most circumstances a Canadian wrapper is no longer necessary for sales of foreign securities to eligible purchasers, although trade reporting filing requirements and other Canadian compliance requirements continue to apply.

#### **B. CHANGES TO CANADIAN PROSPECTUS EXEMPTIONS**

The Canadian Securities Administrators (CSA) adopted several amendments to the prospectus exemptions<sup>9</sup> aimed at enhancing the protection of natural persons. Individuals may no longer use the prospectus exemption for an acquisition of securities with a cost of at least Cdn. \$150,000. Individuals relying on the accredited investor exemption must now execute a risk acknowledgment form,<sup>10</sup> unless they meet minimum financial asset

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8. The exemption from the requirement to disclose statutory rights of action for misrepresentation was adopted through amendments to OSC Rule 45-501 in Ontario, and through the adoption of Multilateral Instrument 45-107 Listing Representations and Statutory Rights of Action Disclosure Exemptions in certain other provinces. The exemption from the requirement to disclose potential conflict-of-interest relationships between dealers and the issuer (or a selling security holder) was implemented through amendments to National Instrument 33-105 Underwriting Conflicts.

9. Amendments to National Instrument 45-106 Prospectus and Registration Exemptions, 38 OSCB 4148 (Can.).

10. See Form 45-106F9, Amendments to National Instrument 45-106 Prospectus and Registration Exemptions, 38 OSCB 2015.

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requirements.<sup>11</sup> The CSA also reminded market participants that reasonable steps should be taken to verify a purchaser's status as an "accredited investor."<sup>12</sup>

The Province of Ontario adopted a prospectus exemption, previously only available in other provinces, for sales of securities to directors, executive officers, control persons, or founders of an issuer, as well as certain family members, close personal friends, and close business associates of those persons.<sup>13</sup>

The "offering memorandum" prospectus exemption, available when a prescribed form of disclosure document is prepared, will be amended to add new investor protections.<sup>14</sup> It is also being adopted in Ontario for the first time.

The rights offering prospectus exemption is being streamlined,<sup>15</sup> to include a simplification of the exemption allowing foreign issuers to extend a rights offering into Canada without following the usual Canadian substantive requirements for a rights offering, if Canadian ownership levels are low enough.

Canada's crowd-funding regime will come into effect on January 25, 2016.<sup>16</sup> Certain disclosure requirements will apply at the time the securities are sold and on an ongoing basis. Securities may only be sold through a registered "funding portal" that meets prescribed requirements and investors will be subject to individual investment limits and overall annual limits.

**C. CHANGES TO THE CANADIAN TAKE-OVER BID REGIME**

The CSA is proposing significant changes to the take-over bid (public tender offer) regime in Canada.<sup>17</sup> The changes would effectively give the target 120 days to respond to a bid. All bids will be subject to a mandatory minimum tender requirement of more than fifty percent of the outstanding securities. The new rules would also require a mandatory ten day extension of a bid following the satisfaction or waiver of all conditions, including the minimum tender requirement.

**D. NATIONAL SECURITIES REGULATOR**

The governments of British Columbia, New Brunswick, Ontario, Prince Edward Island, Saskatchewan, Yukon, and the federal government of Canada are pursuing an initiative to create a Cooperative Capital Markets Regulatory System with a single securities regulatory authority administering a uniform Capital Markets Act. Updated

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11. Beneficial ownership of financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds Cdn. \$5,000,000.

12. See Section 1.9, Companion Policy 45-106CP Prospectus Exemptions, 38 OSCB 4168 (2015).

13. See Amendments to NI 45-106 Prospectus and Registration Exemptions Relating to the Family, Friends and Business Associates Exemption, 38 OSCB 4162 (Can. 2015).

14. See Multilateral CSA Notice Of Amendments to National Instrument 45-106 Prospectus Exemptions Relating To The Offering Memorandum Exemption, 38 OSCB Supp-3 (Can. 2015).

15. See CSA Notice of Amendments Relating to Rights Offerings to National Instrument 45-106 Prospectus Exemptions, 38 OSCB 8277 (Can. 2015).

16. See CSA Notice Of Publication Of Multilateral Instrument 45-108 Crowdfunding, 38 OCSB (Can. 2015).

17. Canadian Securities Administrators, *CSA Notice and Request for Comment Proposed Amendments to Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids* (March 31, 2015), [http://www.albertasecurities.com/Regulatory%20Instruments/5095646\\_CSA\\_Note\\_w%20Annexes\\_62-104.pdf](http://www.albertasecurities.com/Regulatory%20Instruments/5095646_CSA_Note_w%20Annexes_62-104.pdf).

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draft legislation, draft initial regulations, and related materials were published for comment on August 25, 2015.<sup>18</sup>

#### IV. Developments in Germany

##### A. MYSTERIOUS SUIT WITHDRAWAL STUMPS BANK LAW OBSERVERS

An eagerly anticipated German Supreme Court decision (Case No.: XI ZR 154/14)<sup>19</sup> on consumer lending protection rescission rights was suddenly and mysteriously concluded prior to a verdict being issued, but not before speculation had run rampant in the German legal community about the fallout that would result from a verdict surrounding consumer loan rescission rights.

The claimant in the German Supreme Court case, to everyone's great surprise, withdrew his suit against an association of German banks prior to the final verdict being issued. The circumstances surrounding this move remain mysterious, leading to much speculation. Arguments in the case had revolved around mistakes made in the *pro forma* rescission right notice, which bank clients are required to grant to consumer customers when the latter obtain a loan from the former.

Germany has, generally speaking, a complex and formulaic system of consumer protection rules. Even the most seemingly simple and even unimportant violations of specific phrasings and words can trigger the invalidity of the rescission right notice. The consequence of this rescission can be incredibly potent. In most cases, consumers have a contract rescission right that is limited to fourteen days. But when a company fails to follow the law to the exact letter, this can mean that customers have a greatly extended or in some cases indefinite rescission rights—even after performance!

The lower courts had ruled that the lending customer who obtained the loan years ago and serviced all installments without complaint had waived his rescission rights due to conclusive behavior.<sup>20</sup> The customer's appeal to the German Supreme Court had been a last-ditch measure, but one which could have led to an avalanche of loans being reversed.

##### B. NO DAMAGES FOR CURRENCY SWAP CONTRACT DUE TO DEFECTIVE BANK ADVICE

In another case, the German Supreme Court ruled that banks do not owe damages to customers in the context of currency swap contracts, at least as long as the bank is not the direct contract partner of the customer.<sup>21</sup>

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18. *Milestone Reached in the Transition to the Cooperative Capital Markets Regulatory System*, COOPERATIVE CAPITAL MARKETS REGULATORY SYSTEM (Aug. 25, 2015), <http://ccmr-ocrmc.ca/milestone-reached-in-the-transition-to-the-cooperative-capital-markets-regulatory-system-2/>.

19. See BUNDESGERICHTSSHOF [BGH][FEDERAL COURT OF JUSTICE] MAY 16, 2015, TERMINHINWEIS DES BGH: VERWIRKUNG EINES WIDERRUFSRECHTS. XI ZR 154/14, 2015 (Ger.); Press Release, German Supreme Court, "Revisionsrücknahme in Sachen XI ZR 154/14" (Jun. 19, 2015).

20. See Landgericht [LG][Regional Court of Hamburg] July 4, 2015, LANDGERICHT HAMBURG, 328 O 441/12, 2015 (Ger.); Oberlandesgericht [OLG][Hamburg Higher Regional Court] February 26, 2014, HANSEATISCHES OBERLANDESGERICHT HAMBURG, 13 U 71/13, 2014 (Ger.).

21. Bundesgerichtshof [BGH][Federal Court of Justice] Jan. 20, 2015, URTEIL. XI ZR 316/13, 2015 (Ger.).

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The currency swap contract in question was essentially an arbitrage arrangement: the customer borrowed a low-interest amount from one country (Swiss francs) and invested it in higher-yielding investments in another country (Turkish lira). When the target country's currency took a plunge, this had a negative impact on the return.

The German Supreme Court held that because the bank was not itself the contractual party, it did not have a conflict of interest and did not have any obligation to divulge the negative market value of the swap contract. The defendant had merely brokered the contract between the customer and a state-owned bank.

The Court saw the facts differently from a previous case from March 22, 2011 (Case No.: XI ZR 33/10). There, the defendant itself was the contractual partner. In that earlier case, a conflict of interest justified a finding in favor of the claimant. In the 2015 case, the Supreme Court further noted that the claimant was an experienced businessman and thus knew the risks of the transaction.

## V. Developments in India

It was an eventful 2015 for the Indian securities and capital markets. Some key developments are highlighted below.

### A. INSIDER TRADING REGULATIONS, 2015

The Securities and Exchange Board of India (SEBI) released the much-awaited SEBI (Prohibition of Insider Trading) Regulations, 2015 (IT Regulations) which restructured the existing legal regime on the prohibition of insider trading. The IT Regulations have received a mixed response. On the brighter side, the IT Regulations provide clarity on the issue of due diligence which was not dealt with under the previous law.<sup>22</sup> This is a great development, as the new law outlaws abuse of power rather than a legitimate commercial transaction. The IT Regulations now provide express defenses for insiders who may have traded while in possession of unpublished price-sensitive information, which is another laudable development.<sup>23</sup> On the other hand, mere communication of unpublished price-sensitive information, without any trading, is now punishable.<sup>24</sup> This provision has been criticized, as idle talk between people without any substantive action or harm occurring, may now be considered a criminal activity. In addition, the meaning of an "insider" has been expanded to include persons who frequently communicate with company officials.<sup>25</sup>

### B. IPOs AND FAST TRACK ISSUES

With the aim of shortening the timeline for raising capital through IPOs, SEBI has taken steps to remove physical checks for collecting IPO subscriptions. Facilities for online bid-cum-application forms have been expanded. This will make the IPO subscription process easier and faster. In addition, the *Applications Supported by Blocked Amount* (ASBA) mechanism is now mandatory for IPO applicants. This will remove the

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22. Regulation 3(3), IT Regulations of India, 2015 (India).

23. *Id.* at Regulation 4.

24. *Id.* at Regulation 3(2).

25. *Id.*, Regulation 2(1)(d); *see also id.* at Regulation (2)(1)(g).

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scope for any last-minute withdrawals, which have historically been used by notorious intermediaries as a method to generate artificial demand for IPOs. Measures also have been taken to facilitate existing listed companies to raise capital through fast-track issues with relaxed disclosure requirements and shorter timelines.<sup>26</sup>

C. START-UP IPOs

After prolonged debate on how best to facilitate start-up funding through the public markets, SEBI has finally released new listing norms for start-ups with an intention to provide a viable domestic avenue for such companies to raise capital. SEBI has replaced the existing Chapter XC of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) to modify the existing *Institutional Trading Platform* (ITP). The erstwhile ITP did not allow capital raising and was put in place solely for the purpose of providing an exit to its existing investors. The new ITP not only allows start-ups to raise capital, but it also provides several relaxations as compared to the procedures involved in raising capital under the traditional IPO route. This process is to encourage companies that are intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology, or nano-technology to provide products, services, or business platforms with substantial value addition, to access public money. As of now, there is a high minimum application size to ensure that retail investors are not exposed to potentially volatile stocks, but this may change in the future once the platform is tested over time.

Although this is a welcome move, and it would be great to see new-age companies including e-commerce ventures accessing the ITP, the requirement of having such a high institutional holding and a diluted promoter holding may prove to be a hindrance for start-ups to list on the platform.

D. GOING PRIVATE THROUGH A TAKEOVER

SEBI has amended the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Code) to allow promoters or acquirers to take companies “private” by way of a takeover. Acquirers can now potentially acquire all of the shares of a company from its public shareholders through a voluntary or compulsory open offer made under Regulations 3, 4, and 5 of the Takeover Code, subject to compliance with the SEBI (Delisting of Equity Shares) Regulations, 2009 (Delisting Regulations). Delisting in India is a tedious process and requires substantial shareholder approval. Unless appropriate relaxations are made to the Delisting Regulations, it would be procedurally impossible for a rival to take a company private using this route. It seems that SEBI feels that corporate India is still not ready for hostile takeovers.

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<sup>26</sup> Amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, No. LAD-NRO/GN/2009-10/15/174471 (India).



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**VI. Developments in Israel**

A. ENHANCING ATTRACTIVENESS OF TASE

Reduced trading volume and a reduced number of companies listed on The Tel Aviv Stock Exchange Ltd. (TASE) has been a concern for Israeli regulators over the last few years. The Israel Securities Authority (ISA) adopted a “road map” in 2012 for contemplated changes to enhance the attractiveness of the domestic capital market.<sup>27</sup> As part of the road map, in September 2015, the ISA published a proposal for a series of exemptions regarding IPOs in Israel, principally relating to corporate governance, administrative enforcement, and issuance procedures.<sup>28</sup>

In the area of corporate governance, the main exemptions relate to reduced corporate governance requirements for new public companies. For example, in certain circumstances, new public companies would first be required to authorize transactions with controlling shareholders and with CEOs with respect to their terms of service and employment and authorize an officer compensation policy five years from their IPO instead of three years after their IPO. Another exemption would extend the deadline by which new public companies must appoint a balance-sheet committee to recommend approval of financial statements from 90 days to five years after their IPO.<sup>29</sup>

In the field of administrative enforcement by the ISA of securities violations, the ISA proposed - that for a three-year period after the IPO - the ISA would act more leniently towards violations by company officers who did not serve in a senior public company position prior to the IPO. With respect to issuance procedures, the ISA proposes to adopt a series of exemptions to facilitate offerings, including permitting meetings with institutional investors prior to the commencement of the offering, similar to the U.S. model of “test the waters” communications.

In October 2015, the ISA adopted amendments to ease reporting requirements of public companies. These changes included enabling public companies to delay disclosing negotiations prior to entering into a term sheet.<sup>30</sup> Prior to the amendment, public companies were required to disclose all material negotiations with limited exceptions. In addition, the amendments extend the time for companies to report material events, reduce the frequency in which public companies must report changes in holdings of their material shareholders, and reduce various reporting requirements regarding the appointment and termination of officers and certain transactions with controlling shareholders.<sup>31</sup>

It is expected that the ISA will continue to take steps to enhance the attractiveness of the capital markets.

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27. Israel Securities Authority, *Road Map: Targets and Plans for the Coming Years*, (Sep. 2012), available at <http://tinyurl.com/ppxcoq9>.

28. Israel Securities Authority, *Enhancing Initial Public Offering in Israel* (Sep. 20, 2015), available at <http://tinyurl.com/nq8hd8q>.

29. *Id.* at 2.

30. See Amendment to the Securities Regulations (Periodic and Immediate Reports) (No. 3), 5776-1970 (Isr.), available at <http://tinyurl.com/o9dupvl>.

31. *Id.* at 2.

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**B. ELECTRONIC VOTING SYSTEM**

In response to the low participation of public shareholders in shareholders meetings, including data showing that more than fifty-eight percent of the shares held by the public are not voted at shareholders' meetings,<sup>32</sup> the Israeli Parliament (the Knesset) enacted, in 2013, Amendment No. 53 to the Securities Law, 1968, establishing the requirements and procedures for voting in general meetings using electronic voting systems.<sup>33</sup> In June 2015, the ISA implemented a new electronic voting system enabling securities holders to vote from anywhere through a dedicated website, removing any need for public shareholders to fax or mail a voting ballot or obtain ownership certificates from their broker.<sup>34</sup> It is expected that the electronic voting system will enable the investing public to play an increasingly important role in the outcome of significant corporate decisions.

**C. CREDIT RATING AGENCIES**

The Law for Regulating the Activity of Credit Rating Agencies (Credit Rating Agencies Law),<sup>35</sup> which became effective on December 29, 2014 (December 2015 for Israel's two major credit agencies),<sup>36</sup> regulates the conduct of rating agencies and is intended to improve the quality of ratings and reduce conflicts of interests in the ratings process.<sup>37</sup>

Under the Credit Rating Agencies Law, all rating agencies must register with the ISA, which may impose requirements for registration, including minimum capital requirements and insurance coverage.<sup>38</sup> The law imposes financial expertise and independence requirements on the boards of directors of credit agencies and requires directors to supervise the independence of the rating agency, as well as its internal controls, and to identify and address conflicts of interest.<sup>39</sup> In addition, the rating agencies must regularly inspect the quality and reliability of their valuation methods and use those valuation methods in a consistent manner.<sup>40</sup> The law also restricts services, investments, and business relationships of the rating agencies to reduce the risk of conflicts of interest.<sup>41</sup>

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32. Press Release, Isr. Sec. Auth., The Israel Securities Authority Launches an Electronic Voting System (June 29, 2015).

33. Israel Securities Authority, Report on the Activities of the Israel Securities Authority 129 (2013).

34. See Israeli Securities Authority, 2014 Annual Report, 10, 91 (May 2015), available at <http://tinyurl.com/qesuso3>.

35. See Law to Regulate the Activity of Credit Rating Companies, 5774-2014 (Isr.).

36. Israel Securities Authority, *supra* note 34, at 24.

37. *Id.*

38. *Id.* at 90.

39. Law to Regulate the Activity of Credit Rating Companies, *supra* note 35, § 9(2)-(4).

40. *Id.* § 15(a)(2).

41. See *id.* § 16.

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**VII. Developments in Japan**

A. CORPORATE GOVERNANCE REFORM IN JAPAN

The implementation of a formal Corporate Governance Code (the “Governance Code”)<sup>42</sup> on June 1, 2015, was a significant step towards a more efficient equities market in Japan. The Governance Code is the final component of a multi-pronged regulatory and policy effort of the Japanese government to improve corporate governance and transparency at Japanese public companies by nudging them to take into consideration global standards and practices and the needs and perspectives of shareholders and other stakeholders. The other primary components of the policy effort include the introduction in 2014 of a Stewardship Code (the Stewardship Code)<sup>43</sup> for institutional investors and the introduction in 2014 of an index for “quality” public equities, (the JPX-Nikkei 400<sup>44</sup> and together with the Governance Code and the Stewardship Code, the Corporate Governance Reforms).

*Governance Code.* The Governance Code is modeled on the OECD Principles of Corporate Governance and bears the strong influence of the UK Corporate Governance Code. The Governance Code is part of the listing rules and regulations of the Tokyo Stock Exchange (the TSE). It applies to all companies listed on the main market of the TSE, but is not legally binding.

Similar to the UK Corporate Governance Code, the Governance Code utilizes a “principles-based” approach (as opposed to a “rules-based” approach), that requires listed companies to determine, based on the purpose and spirit of each principle outlined in the Governance Code, whether their governance activities are in line with each relevant principle. Also, similar to the UK Corporate Governance Code, the Governance Code utilizes a “comply-or-explain” approach, which requires listed companies to comply with each principle or explain its reasons for non-compliance.

The most notable requirement of the Governance Code is that listed companies are to appoint at least two independent directors or explain why they have not done so. While the Governance Code’s requirement to appoint at least two independent directors is not legally binding, the Companies Act of Japan was amended in June 2014 to specifically require companies to explain why they do not appoint at least one independent director. The explanation for not complying with the independent director requirement is to be set forth in an annual report to be filed with the TSE within six months following the annual shareholder meeting.

*Stewardship Code.* The Stewardship Code promulgated by the Financial Services Agency of Japan in 2014 shares many characteristics with the Governance Code because it is modeled in large part on a UK model, the UK Stewardship Code, is not legally binding, and relies on a “comply-or-explain” approach.

Institutional investors that invest in Japanese-listed equities are encouraged to adopt the Stewardship Code, which is essentially a code of behavior for institutional investors to

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42. *Formulation of “Japan’s Corporate Governance Code”*, MARKET NEWS (May 13, 2015), <http://www.jpx.co.jp/english/news/1020/20150511-02.html>.

43. See Japan’s Stewardship Code, April 2014, *available at* <http://www.fsa.go.jp/en/refer/councils/stewardship/20140407/01.pdf>.

44. See JPX-Nikkei Index 400 Guidebook, November 2013 (Japan).

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engage with investee entities taking into consideration the needs of their clients and beneficiaries as well as the circumstances of the investee companies. Upon adoption of the Stewardship Code, the investor is expected to: (a) disclose how they vote at annual general meetings; and (b) have engaged with investee company management to improve corporate governance and shareholder returns. The Stewardship Code has been adopted by nearly every major Japanese institutional investor, including the US \$1.3 trillion Government Pension Investment Fund, the world's largest pension fund.

*The JPX-Nikkei 400.* Recognizing that the corporate governance and stewardship codes are only principle-based guidelines, and to encourage corporate Japan to adhere to these principles, the Japan Exchange Group, the TSE, and Nikkei Inc. established the JPX-Nikkei 400, an index of 400 TSE listed equities that meet global investment standards for both corporate governance and profitability thresholds. Companies included in the index are in effect deemed to be highly attractive to investors.

- The principal quantitative criteria for inclusion in the JPX-Nikkei 400 include:
- 3 year Return on Equity;
- 3 year Cumulative Operating Profit; and
- Market Capitalization.

To encourage adoption of global corporate governance standards, the principal qualitative factors for inclusion in the JPX-Nikkei 400 are:

- Independent Directors (at least 2);
- Adoption of International Financial Reporting Standards (IFRS); and
- Disclosure of Earnings in English.

Inclusion in the JPX-Nikkei 400 can be viewed as a reward for companies that have better governance and an incentive for those companies with poor governance to improve and be included in the index.

### **VIII. Developments in Mexico**

Mexico has one of the leading capital markets in Latin America. In recent years, capital markets have benefited from regulatory efforts to improve competitiveness and attract more foreign financial institutions and participants.

As a result of the structural reforms recently enacted by the government, Mexico has opened certain strategic sectors, including energy,<sup>45</sup> telecommunications, and infrastructure to private sector participation. Related finance<sup>46</sup> and tax reforms have also been enacted. As a result of these historic reforms, the Mexican government and the Mexican Stock Exchange (BMV) created a new financial instrument to provide funding and tax incentives for energy and infrastructure projects. Loosely based on the tax structure of master limited partnerships (MLPs) in the United States, the government

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45. Decreto por el que se reforman y adicionan diversas disposiciones de la Constitución Política de los Estados Unidos Mexicanos, en Materia de Energía, Diario Oficial de la Federación [DOF] 20-12-2013 (Mex.).

46. Decreto por el que se reforman, adicionan y derogan diversas disposiciones en materia financiera y se expide la Ley para Regular las Agrupaciones Financieras, (Continúa en la Tercera Sección), Diario Oficial de la Federación [DOF] 10-1-2014, decreto DOF (Mex.).

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launched an instrument known as a “FIBRA-E” (energy and infrastructure investment trust or *fideicomiso de inversion en energía e infraestructura*).

FIBRA-E was implemented through the amendment of securities regulations<sup>47</sup> issued by the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) and of tax regulations<sup>48</sup> issued by the Mexican Internal Revenue Service (*Sistema de Administración Tributaria*).

The purpose of a FIBRA-E is to invest in the capital stock of companies holding energy or infrastructure assets (Portfolio Companies). Among other requirements, a Portfolio Company must be incorporated as a Mexican legal entity and reside in Mexico for tax purposes.<sup>49</sup> At least ninety percent of its annual taxable income must be derived from any of the following exclusive activities:<sup>50</sup>

- a. the treatment, refining, transportation, and storage of oil, natural gas, and oil products such as petrochemicals;
- b. the generation, transmission, and distribution of electricity; and infrastructure investment projects<sup>51</sup> (including concessions or other government contracts) in: (i) roads, highways, railways, and bridges; (ii) ports and maritime terminals; (iii) publicly accessible civilian airfields; (iv) expansion of the country’s telecommunications network; (v) public safety and social reintegration; and (vi) drinking water, sewage, and wastewater treatment facilities.

At least seventy percent of the average annual value of the total assets of a FIBRA-E must be directly invested in the capital stock of Portfolio Companies. The remaining portion can only be invested in securities issued by the Federal Government (registered in the National Securities Registry) or in investment companies or funds whose assets consist solely of debt securities.<sup>52</sup>

A FIBRA-E must distribute at least ninety-five percent of its after-tax income from the preceding year to its investors on a yearly basis (similar to a U.S. MLP).<sup>53</sup>

As a general rule, distributions by a FIBRA-E are subject to a thirty percent withholding tax (other than to exempt investors such as Mexican pension funds).<sup>54</sup> Some investors, including foreign residents without permanent establishment in Mexico, are exempt from income tax on the gain from the sale of FIBRA-E certificates if such sale is made through the BMV.

The current tax rules impose several liability on all shareholders of a Portfolio Company for any tax liability of the Portfolio Company arising out of the ownership by

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47. Comisión Nacional Bancaria y de Valores, CNBV, SAT, Secretaría de Hacienda y Crédito Público [SHCP] 31-12-2015, disposiciones de carácter 2015 DOF 19-3-2015, formata PDF, <http://www.cnbv.gob.mx/Normatividad/Disposiciones%20de%20car%C3%A1cter%20general%20aplicables%20a%20las%20emisoras%20de%20valores.pdf>.

48. Servicio de Administración Tributaria, SAT, Secretaría de Hacienda y Crédito Público [SHCP] 29-9-2015, resolución miscelánea fiscal para 2015 DOF 30-12-2014 (Mex.), formato docx, [http://www.sat.gob.mx/informacion\\_fiscal/normatividad/Documents/RMF2015\\_compilacion\\_4resolucion.docx](http://www.sat.gob.mx/informacion_fiscal/normatividad/Documents/RMF2015_compilacion_4resolucion.docx) (Mex.).

49. *Id.* § 3.21.3.7, II, (a).

50. *Id.* § 3.21.3.7, II, (b).

51. Each project must be currently in operation and have a remaining term of at least 7 years.

52. Servicio de Administración Tributaria, *supra* note 48, § 3.21.3.7, III.

53. *Id.* § 3.21.3.7, V.

54. *Id.* § 3.21.3.8.

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the FIBRA-E of such Portfolio Company.<sup>55</sup> This is one of the most controversial aspects of the new rules and has been sharply criticized.

**IX. Developments in the United Kingdom**

**A. NEW PROCEDURES REGARDING ELECTRONIC SETTLEMENT OF U.S. REGULATION S, CATEGORY 3 SECURITIES TRADING ON THE LONDON STOCK EXCHANGE**

On August 28, 2014, Article 3(2) of the European Union Regulation on Central Securities Depositories (CSDR) was enacted.<sup>56</sup> This provision indirectly mandated changes to the London Stock Exchange's rules in that it required that all securities on European Union trading venues must be recorded in electronic (*i.e.*, book-entry) form in a Central Securities Depository (CSD). After two extensions from the original effective date of January 5, 2015, the CSDR became effective for securities of U.S. companies trading on the London Stock Exchange on September 1, 2015.

Regulation S (Regulation S) of the U.S. Securities Act of 1933, as amended (Securities Act),<sup>57</sup> provides a safe harbor from the Section 5 registration requirements of the Securities Act<sup>58</sup> for offerings outside of the United States by both U.S. and non-U.S. issuers. Because there is the risk that any security that is sold outside of the United States might flow back into the United States, Regulation S sets forth restrictions for three categories of transactions. Regulation S, Category 3 Securities<sup>59</sup> (as defined in Regulation S) have the most restrictive offering and transactional procedures, including a one-year distribution compliance period, because these issuers have a close nexus with the United States.

Prior to the effective date of the CSDR, Regulation S, Category 3 Securities were exempt from the London Stock Exchange's AIM Rule 36<sup>60</sup> which provided that an issuer's securities must be eligible for electronic settlement in order to be traded on the London Stock Exchange. The exemption was necessary because Regulation S, Category 3 Securities were required to have legends attached (stating the relevant restrictions applicable to them), which made them ineligible for settlement in the electronic CREST settlement system. Such securities were therefore settled outside of CREST in physical, certificated form.

**B. THE NEW ELECTRONIC PROCEDURES**

As a result of the CSDR, the London Stock Exchange and Euroclear UK and Ireland Limited (EUI, which owns and operates CREST) developed a set of procedures to facilitate the electronic settlement of Regulation S, Category 3 Securities in compliance

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55. *Id.* § 3.21.3.7., II, (d).

56. See Regulation 909/2014, of the European Parliament and of the Council of 23 July 2014 on Improving Securities Settlement in the European Union and on Central Securities Depositories and Amending Directives 98/26/EC and 2014/65/EU and Regulation 236/2012, 2014 O.J. (L 257/1).

57. See 17 C.F.R. § 230 (2015).

58. 15 U.S.C. § 77a (2012).

59. 17 C.F.R. § 230.903 (2015).

60. London Stock Exchange, *AIM Rules for Companies. Rule 36: Settlement*, (Jan. 2016), available at <http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/rules/regulation.htm>.

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with the Securities Act and the CSDR. On May 11, 2015, EUI published a whitebook<sup>61</sup> (Whitebook) on its new “Euroclear UK & Ireland: Regulation S Category 3 Settlement Service.” The Whitebook outlined EUI’s changes to the CREST system in relation to the holding and transfer of Regulation S, Category 3 Securities as well as any eligible resales under Rule 144A of the Securities Act.

The procedures developed by the London Stock Exchange and EUI allow for electronic settlement while facilitating compliance with the Regulation S, Category 3 restrictions and, as such, require, among other things, that:

- issuers (or their registrars, as the case may be) indicate to the London Stock Exchange and EUI that:
  - their securities are subject to Regulation S, Category 3 restrictions (and, if applicable, that such securities are eligible to be resold under Rule 144A) on the relevant admission form; and
  - the expected date on which the relevant distribution compliance period will end.
- issuers notify the London Stock Exchange and EUI once the distribution compliance period ends.
- each purchaser of securities (or the beneficial owner of such securities) completes electronic purchaser certifications (available via CREST), indicating, *inter alia*, that:
  - it is not a U.S. person and it is not purchasing the securities for the account or on behalf of a U.S. person; or, to the extent applicable, it is a U.S. person who is also a QIB and who is purchasing in reliance on Rule 144A or another available exemption from, or transaction not subject to, the Securities Act;
  - it will resell the securities only in accordance with Regulation S, pursuant to registration under the Securities Act or pursuant to an available exemption from, or in a transaction not subject to, the registration requirements of the Securities Act; and
  - it is neither the issuer of the Regulation S, Category 3 Securities nor an affiliate of the issuer.

Failing to provide electronic purchaser certifications results in settlement through CREST being denied (and subsequently the trade is unwound), the effect of which is that there is no transfer on the CREST register, which represents the official register of legal title of an issuer’s securities to the extent they are held in CREST in uncertificated form. This has the same effect as a refusal by the issuer to register the transfer of securities.

**C. THE IMPORTANCE OF THE NEW PROCEDURES**

Regulation S, Category 3 Securities have historically experienced low liquidity in the secondary market compared to securities of comparable issuers trading and settling electronically. In addition, as a result of trading in certificated form, settlement of Regulation S, Category 3 Securities generally took between 10 days and two weeks, as compared to electronic settlement which generally takes two days. Such low liquidity was believed to be, at least in part, due to the fact that these securities were traded and settled

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<sup>61</sup> See Euroclear UK & Ireland, Regulation S Category 3 Settlement Service (May 11, 2015).

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in certificated form resulting in such long settlement periods. The long settlement periods and related poor liquidity is also believed to have negatively affected pricing.

It is expected that now that Regulation S, Category 3 Securities can settle electronically, they will see increased liquidity and present an appealing option for U.S. issuers seeking to raise capital in the London markets. Issuers are still, of course, responsible for compliance with all U.S. securities laws. While using the CREST system will not automatically establish such compliance, it will allow Regulation S, Category 3 Securities to trade electronically through CREST in accordance with the CSDR while facilitating compliance with the requirements imposed on Regulation S, Category 3 Securities under U.S. securities laws by following the new procedures established by the London Stock Exchange and EU.

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