International Securities and Capital Markets

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The following article summarizes selected developments during 2011 in the regulation of international securities and capital markets in Australia, Brazil, China, the EU, Germany, Japan, and Peru.[1]

I. Australia**

A. Australian Executive Remuneration Reform—The "Two Strikes Rule"

The introduction of the "two strikes rule"[2] changed the dynamic between the board of directors and shareholders in relation to the determination of executive remuneration. Before this reform, the landscape in Australia centered on a "non-binding vote" system, which was introduced in 2004–2005.[3] Under the prior system, the board would set remuneration and policy, but all listed companies were required to include a resolution at their annual general meeting (AGM) in relation to the adoption of the company's remuneration

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1. For developments in selected jurisdictions during 2010, *see* João Otávio Pinheiro Olivério et al., *International Securities and Capital Markets*, 45 Int'l Law. 253 (2011). For developments during 2009, *see* Walter Stuber et al., 44 Int'l Law. 301 (2010).

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2. *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011* (Cth) (Austl.) [hereinafter *Executive Remuneration Act*].

3. *See Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) (Austl.).

report[4] (a report that identifies key executives' remuneration and the remuneration policy as set by the board).[5] The vote on the resolution was non-binding.[6] Accordingly, ultimate power in determining executive remuneration remained with the board, not the shareholders.

The effectiveness of the "non-binding vote" system was evaluated by the Australian government's Productivity Commission Report.[7] The report found that the "non-binding vote" generally encouraged engagement on remuneration between companies and shareholders, and that boards were sensitive to votes against the remuneration report.[8] But some boards failed to take any action despite consecutive years of significant "no" votes[9] and, as a result, the Productivity Commission recommended the "two strikes rule."[10] That rule is now the law.[11]

In short, the "two strikes rule" works as follows:

- At each AGM, shareholders must vote on the adoption of the remuneration report (strike resolution); and
- if, at any AGM, at least twenty-five percent of the votes cast on the strike resolution are "no" votes; and
- at the subsequent AGM (second AGM), at least twenty-five percent of the votes cast on the strike resolution are "no" votes; then,
- a resolution to hold a shareholders meeting to replace the entire board other than the CEO (spill resolution) must be put to shareholders at the second AGM. If at least fifty percent of the votes cast on the spill resolution are "yes" votes; then,
- a shareholders meeting to replace the board (spill meeting) must be held within ninety days of the second AGM, at which the directors (other than the CEO) must stand for re-election.[12]

Although in its early stages, a number of criticisms have been made against the "two strikes rule," including that the rule will lead to additional compliance costs and could be used for ulterior purposes (for example, board destabilization in the context of a potential control transaction). A more significant criticism is that the threshold for triggering a board re-election is too low, particularly given the low shareholder turnout rate at AGMs,[13] and that key executives and directors and their associated parties are excluded from voting on the strike and spill resolutions but not the spill meeting.[14] As such, a few

4. *Corporations Act 2001* (Cth) s 250R(2) (Austl.) [hereinafter *Corporations Act*].

5. *Id.* s 300A.

6. *Id.* s 250R(3).

7. Productivity Commission 2009, *Executive Remuneration in Australia*, Report N. 49, Final Inquiry Report, Melbourne [hereinafter PC Report].

8. *Id.* at 281. This sensitivity was displayed by many corporations that amended their remuneration arrangements in response to "no" votes. These corporations include: Wesfarmers (2008–2009), Boral (2008–2009), Suncorp-Metway (2008–2009), Toll (2008–2009), Telstra (2007–2008). *Id.*

9. *Id.* at 297. Companies that failed to take action include: Crane Group (2007–2010), Qantas (2008–2009), Transurban (2008–2010). *Id.*

10. *See id.* at 329 (Recommendation 15).

11. Executive Remuneration Act 2011, (Cth) ss 9, 13 (Austl.).

12. Corporations Act 2001, (Cth) ss 250U-250W (Austl.).

13. *See* PC Report, *supra* note 7, at 302. In 2008, voting participation in ASX200 companies averaged 54% on remuneration report resolutions (thereby only requiring 13.5% of shareholders to action a strike resolution). *Id.* at 301.

14. Corporations Act, s 250R(4).

minority shareholders could force a board re-election process, even in circumstances where there is a very low prospect of the existing board not being re-elected. For example, in a company where a chairman controls 50.1% of voting shares, the chairman would be unable to vote on the strike or spill resolutions, which makes it easier for a few minority shareholders to force a board re-election. But there would be little or no risk of a board spill as the chairman could vote on the board re-election resolutions. One reform we have recommended is to allow key executives and directors to vote on the spill resolution, bringing the voting rules into line with the spill meeting rules and thereby avoiding the distraction and cost of a redundant shareholder meeting.

Following the 2011 AGM season, there are a number of companies that have received their first "strike"[15]; however, the true impact of the reforms will only be seen following the 2012 AGM season.

II. Brazil*

A. The New Rules for Autonomous Investment Agents in Brazil

By means of CVM Instruction No. 497 of June 3, 2011, the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários* – CVM) issued new rules that apply to the autonomous investment agents, effective January 1, 2012.[16] The main objective of the new regulation is to make the role of the autonomous investment agent more transparent due to the expansion of the Brazilian capital markets. The autonomous investment agent remains as a distributor of products to service intermediaries.

The definition of the activities permitted to these agents crystallizes the solutions considered most appropriate for dealing with problems, by listing the prohibitions applied to the activity and presenting a framework of obligations and responsibilities to the market participants. All these changes aim at reducing possible fields of uncertainty for clients, mainly through the strengthening of the liability of intermediaries for the action of the autonomous investment agents and through the enhancement of the control mechanisms. The autonomous investment agents are characterized as "extensions of the securities brokers" as they represent centers of securities distribution, often located in distant regions of the country. In summary, the new regulation contemplates, among other measures, the following:

(i) A clearer definition of the contents of the autonomous investment agents' activities, previously generically referred to as "distribution and mediation of securities" under the responsibility of the intermediary. Such a definition makes the acts involved in the distribution of securities safer.

(ii) The mandatory adoption of certain practices to monitor the performance of the autonomous investment agents and its own clients by institutions of the Brazilian securi-

15. Austock Group, BlueScope Steel, Cabcharge Australia, Globe International, News Corporation, Perpetual, Sirtex Medical, Tassal Group and UGL have received their first "strike." Ted Allen, *Twelve Austrailian Companies Receive First Strike Votes*, ISS Governance (Nov. 18, 2011 4:32 PM), http://blog.issgovernance.com/gov/2011/11/twelve-australian-companies-receive-first-strike-votes.html.

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16. *See* Decreto No. 497, de 3 de Junho de 2011, *Diário Oficial da União* [D.O.U], de 1.1.2012 (Braz.), *available at* http://www.cvm.gov.br.

ties distribution system, as well as the implementation of control mechanisms that are more appropriate to the new market reality.

(iii) The obligation of exclusive contractual relationship with an intermediary (with one exception that is outlined below), in view of the activities carried out by the autonomous investment agents and the risks entailed. Thus, the activities under the responsibility of a certain intermediary are more easily subject to control mechanisms and the intermediary will have to comply with its duty of supervision.

(iv) A new framework for accreditation and registration of autonomous investment agents to be implemented by a private entity subject to the authorization and supervision of CVM (the licensing authority), with the adoption of mechanisms for certification and continuing education. This new structure is intended to give greater agility to the processes of accreditation and cancellation of autonomous investment agents, still improving the system of access to this activity. CVM included an exhaustive list of the activities permitted to the autonomous investment agents, which are now limited to three levels: (i) prospecting and client acquisition, (ii) receiving, recording, and transmission of orders, and (iii) providing information on products and services of an intermediary (securities broker) to which the agent is bound.

Only individuals (natural persons) may act as autonomous investment agents. But the new regulation permits the formation of a legal entity or sole proprietorship for the provision of services, provided that only accredited agents are holders of the company's capital stock. This is a prerogative to be exercised exclusively for tax purposes and confirms the burden of personhood activity attributed by CVM to the autonomous investment agents and strengthens the accountability mechanisms of the agents' liability. To carry out the activities of portfolio management, consulting, or analysis of securities, the autonomous investment agent that is registered by CVM for the performance of those activities under the regulations in force shall apply to the licensing authority to suspend its accreditation as an autonomous investment agent. The autonomous investment agent that maintains a contract with an intermediary through a legal entity or sole proprietorship, as permitted in the new regulation, cannot be engaged directly by another intermediary. The great innovation introduced by CVM is the exclusivity of the autonomous investment agent to a single intermediary.

The new regulation stresses the responsibility of the securities brokers with clients and third parties for the acts committed by the autonomous investment agents linked to them. In this regard, it reaffirms the understanding that the prospective clients originated by the autonomous investment agents are the responsibility of the securities brokers as if they were prospected by their own employees. Measures such as approval and control of materials used by the autonomous investment agents, routine check of recordings and broadcasts of orders, monitoring the relationship between the autonomous investment agents and their networks of contacts, and monitoring of clients operations, among others, will be part of the agenda of the securities brokers as a way of managing the risks inherent in outsourcing. With such regulation, CVM seeks to improve the rules for autonomous investment agents, recognizes their importance in the popularization of the capital market, and makes use of a liability structure compatible with the extension of the client base of securities brokers.

III. European Union

A. Most Important Activities Of The EU Governing Bodies**

As in the previous years, the European Union reacted to the challenges of the financial markets with a review of existing legal provisions and the publication of proposals for future directives and regulations.

1. *Proposal Regarding Insider Dealing and Market Manipulation (i.e. market abuse)*

On October 20, 2011, the European Commission published a proposal for a Directive on criminal sanctions for insider dealing and market manipulation,[17] together with a proposal for a Regulation on insider dealing and market manipulation.[18] The Commission considers the current sanctions for market abuse in the EU Member States as not sufficient and heterogeneous. A level playing field can only be obtained if all Member States provide for criminal sanctions for market abuse. Currently, some states only impose administrative (monetary) sanctions that, in the opinion of the Commission,[19] are insufficiently dissuasive. Twenty-four months after entry into force of this Directive, EU Member States will be required to regard insider dealing[20] and market manipulation[21] as criminal offences if committed intentionally. The attempt should also be punishable as a criminal offense.[22]

The proposed Regulation is designed to extend its scope by also covering financial instruments admitted to trading not only on a regulated market but also on a multilateral trading facility (MTF) or an organized trading facility (OTF), as well as to any related financial instruments traded over the counter (OTC) that can have an effect on the covered underlying market. The Regulation will further apply to commodity derivatives and the related spot commodity contracts as well as emission allowances.[23] Some high frequency trading strategies are considered as market manipulation (*e.g.*, "quote stuffing").[24] Finally, regulators shall have more efficient investigative and sanctioning powers.[25]

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17. *See Commission Proposal for a Directive of the European Parliament and the Council on Criminal Sanctions for Insider Dealing and Marker Manipulation*, COM (2011) 654 final (Oct. 20, 2011) [hereinafter *Directive*], *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0654:FIN:EN:PDF.

18. *See Commission Proposal for a Regulation of the European Parliament and of the Council on Insider Dealing and Market Manipulation (Market Abuse)*, COM (2011) 651 final (Oct. 22, 2011), [hereinafter *Regulation*], *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0651:FIN:EN:PDF.

19. *Id.* at 2 (quoting *Report of the High-Level Group on Financial Supervision*, 23 (Feb. 25, 2009), *available at* http://ec.europa.edu/international_market/finances/docs/de_larosiere_report_en.pdf).

20. *Directive*, *supra* note 17, art. 3.

21. *Id.* art. 4.

22. *Id.* art. 5.

23. *Regulation*, *supra* note 18, art. 2.

24. *Id.* art. 8.

25. *Id.* art. 17.

2. *Proposal Regarding Markets in Financial Instruments (MiFID)*

On October 20, 2011, the Commission published proposals for a Directive on markets in financial instruments, repealing Directive 2004/39/EC,[26] and for a Regulation on markets in financial instruments, and amending Regulation [EMIR] on OTC derivatives, central counterparties, and trade repositories.[27]

One major goal of the proposed rules is to provide a level playing field for financial instruments. To this end, all organized trading shall be conducted on regulated trading venues, which shall encompass regulated markets, multilateral trading facilities (MTFs), and organized trading facilities (OTFs). Identical pre- and post-trade transparency requirements shall apply to all of these venues.

The level of information for potential investors and clients shall be increased. As a consequence, transparency rules applicable to shares shall also apply to equity-like instruments such as depository receipts, exchange-traded funds, certificates, and other similar financial instruments issued by companies. Similar rules shall cover bonds, structured finance products, emission allowances, and derivatives. The proposed Directive also includes new rules on improved corporate governance and on enhanced organizational requirements of an investment firm. Emissions allowances will be added to the definition of financial instruments covered by MiFID.

3. *Proposals on Credit Rating Agencies*

On November 15, 2011, the EU Commission published a set of proposals to curb the influence of Credit Rating Agencies (CRA) and to increase the regulation of their conduct.[28] Investment funds and alternative investment funds shall not solely or mechanistically rely on external credit ratings for assessing the creditworthiness of the assets. External credit ratings may be used as one factor among others in this process but shall not prevail.

Issuers of structured finance instruments shall be required to engage two credit rating agencies, independent from each other, to issue two independent credit ratings in parallel. CRAs shall be prohibited from rating major shareholders or entities/financial instruments the CRA has a significant interest in. Lead rating analysts should not be involved in rating the same entity for more than four years. In addition, CRAs should submit the proposed methodologies to ESMA for the assessment of their compliance with existing require-

26. Council Directive 2004/39/EC, 2004, O.J. (L145) 1 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0656:FIN:EN:PDF.

27. *Proposal for a Regulation of the European Parliament and of the Council on markets in Financial Instruments and Amending Regulation [EMIR] on OTC Derivatives, Central Counterparties and Trade Repositories*, COM (2011) 652 final (Oct. 20, 2011), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0652:FIN:EN:PDF.

28. *Directive 2009/65/EC, of the European Parliament and of the Council Amending Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings of Collective Investment in Transferable Securities (UCITS) and Directive 2011/61/EU on Alternative Investment Funds Managers in Respect of the Excessive Reliance on Credit Ratings*, COM (2011) 746 final (Nov. 15, 2011), *available at* http://ec.europa.eu/internal_market/securities/docs/agencies/COM_2011_746_en.pdf; *Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies*, COM (2011) 746 final (Nov. 15, 2011), *available at* http://ec.europa.eu/internal_market/securities/docs/agencies/COM_2011_747_en.pdf.

ments. In relation to sovereign ratings, CRAs shall assess ratings every six months (instead of twelve months) and have to provide a full research report when issuing and amending sovereign ratings, to improve transparency and enhance users' understanding.

B. New Risk Retention And Capital Requirements For European Securitization*

The year 2011 was another challenging year for the securitization markets in Europe. Although the amount of new issuance in the first six months of the year almost doubled compared to the same period in 2010, the majority of this was retained on the balance sheets of the originators or sponsors to secure central bank funding.[29] The amount actually placed with third-party investors remained far below the peak of 2006.[30] Meanwhile, market participants grappled with the new risk retention and other provisions of Article 122a of the Capital Requirements Directive (CRD), while regulators continued to refine new capital requirements for banks, insurers, and pension funds that have securitization exposures.

1. *Article 122a*

Article 122a of the CRD came into effect for new securitizations on January 1, 2011.[31] Adopted in 2009 by the European Commission (EC) as part of the amendments known as "CRD2," Article 122a provides that European credit institutions may only invest in or otherwise be exposed to the credit risk of securitizations if the originator, sponsor, or original lender retains at least five percent of the risk. Article 122a also imposes due diligence, disclosure, and monitoring requirements on those credit institutions.

On December 31, 2010, the Committee of European Banking Supervisors (CEBS) published guidelines on the application of Article 122a.[32] Nevertheless, a number of questions have arisen regarding how the new requirements should be applied in practice. The European Banking Authority (EBA), which replaced the CEBS at the beginning of the year, published a Q&A paper on September 29, 2011, with answers to some of these questions.[33] This document provides interpretive guidance on specific paragraphs of Article 122a and the guidelines, as well as clarifications regarding the application of the rules

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29. *See* Association for Financial Markets in Europe, AFME/ESF Securitisation Data Report Q2:2011 (Sept. 13, 2011), *available at* http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=5627.

30. *Id. See also* Hans J. Blommestein, et al., *Outlook for the Securitisation Market*, OECD J: Fin. Market Trends, no. 1, at 4, *available at* http://www.oecd.org/dataoecd/36/44/48620405.pdf.

31. Directive 2009/111/EC, of the European Parliament and of the Council of September 16, 2009, Amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as Regards Banks Affiliated to Central Institutions, Certain Own Funds Items, Large Exposures, Supervisory Arrangements, and Crisis Management, 2009 O.J. (L 302/97) 1, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0097:0119:EN:PDF.

32. *See Guidelines to Article 122a of the Capital Requirements Directive*, Committee of European Banking Supervisors (Dec. 31, 2010), http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf.

33. *See* Q&A on Guidelines to Article 122a of the Capital Requirements Directive, Committee of European Banking Supervisors (Sept. 29, 2011), http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2011/EBA-BS-2011-126-rev1(QA-on-guidelines-Artt122a).pdf.

to asset-backed commercial paper conduits, correlation trading, and managed collateralized loan obligations.

Significantly, the Q&A paper states that participants must look to the "economic substance" of a transaction to determine whether it constitutes a securitization for purposes of Article 122a.[34] This approach, together with some of the EBA's answers regarding the level of disclosure and due diligence that may be required in certain circumstances, provides a degree of flexibility but perpetuates some uncertainty as well. A consensus regarding these and other points should emerge as market practice develops into 2012.

2. *Capital Requirements*

In addition to CRD2, the EC in December 2010 published further amendments to the CRD (CRD3) that will introduce higher capital requirements for re-securitization exposures and for securitization positions held in the trading book.[35] CRD3 also requires a bank to treat a securitization position as unrated, thus increasing its capital charge, if the credit assessment is based in whole or in part on unfunded support provided by the bank itself, and enhances disclosure requirements.[36] Member States must implement CRD3 by December 31, 2011.[37]

Discussions continued in 2011 regarding the implementing measures for Solvency II, the new regulatory regime for insurers in the European Union, which is currently scheduled to be effective by January 1, 2014.[38] Solvency II will impose higher capital charges on asset-backed securities for insurers and pension funds compared to other investments, such as covered bonds, which could put securitizations at a disadvantage. The European Insurance and Occupational Pensions Authority announced that it intends to finalize its proposals in September 2012.[39]

Finally, the EC published a legislative proposal for further revisions to the CRD on July 20, 2011.[40] Known as "CRD4," the new amendments will translate the Basel III frame-

34. *Id.* § I.

35. *See* Directive 2010/76/EU, of the European Parliament and of the Council of November 24, 2010, Amending Directives 2006/48/EC and 2006/49/EC and 2007/64/EC as Regards Capital Requirements for the Trading Book and for Re-securitizations, and the Supervisory Review of Remuneration Policies, 2010 O.J. (L 329/3) 1, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:329:0003:0035:en:PDF.

36. *Id.*

37. *Id.*

38. *See* Directive 2009/138/EC, of the European Parliament and of the Council of November 25, 2009 on the Taking-up and Pursuit of the Business of Insurance and Reinsurance (Solvency II) (recast), 2009 O.J. (L 335/1) 1, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:335:0001:0155:EN:PDF; *see also* Press Release, European Insurance and Occupational Pensions Authority, First EIOPA Conference Attracts 350 Participants – EIOPA Provides Update on Work on Solvency II (Nov. 16, 2011), https://eiopa.europa.eu/fileadmin/tx_dam/files/Press-Room/AnnualConference-SolII-Update.pdf [hereinafter EIOPA Press Release].

39. *See* EIOPA Press Release, *supra* note 38.

40. *See Proposal for a Directive of the European Parliament and of the Council on the Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms and Amending Directive 2002/87/EC of the European Parliament and of the Council on the Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate*, COM (2011) 453 final, (July 7, 2011), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0453:FIN:EN:PDF; *see also Proposal for a Regulation of the European Parliament and of the Council on Prudential Requirements for Credit*

work into new regulatory capital and liquidity ratios for European banks, which will also have an impact on securitization.

The formulation of higher capital charges to ensure the soundness of the financial system has been the subject of much debate. With an estimated EUR 1.0 trillion of debt due for refinancing over the next two years and bond investors increasingly wary of lending to banks with large sovereign exposures, the securitization markets could be a crucial source of funds for European financial institutions.[41] Whether increased capital requirements for securitizations together with the requirements of Article 122a will impede or promote investment remains to be seen.

IV. Japan and China*

A. Corporate Governance Prospects

1. *Japan*

The revelations of accounting fraud and other irregularities involving suspect payments and write downs of US$1 billion or more at Olympus Corp. that surfaced in the fall of 2011 have yet to be investigated and resolved. Yet one fact stands out: the revelations and the ensuing controversy highlight corporate and official Japan's continuing struggle to improve the corporate governance of public companies. The key question for corporate Japan, and indirectly for foreign investors, is whether the Olympus scandal will be the one that finally brings better corporate governance of the kind that will sustain international confidence in Japan's capital markets and corporations. Perhaps the more important aspect of the Olympus scandal is not the alleged wrongdoing per se, which is not too dissimilar from that found in other countries (i.e., misleading accounting skullduggery). What is more revealing is the tepid official response, or in some views, the lack thereof. This is not to say that Japan does not have the legal and regulatory framework to deal with corporate governance problems—it does. After the Enron and WorldCom scandals and the subsequent adoption of the Sarbanes Oxley regime in the United States, Japan instituted similar requirements for public companies (commonly referred to as J-SOX).[42] What the Olympus situation highlights for foreign investors is the questionable enforcement and adequacy of the existing corporate governance framework in Japan. Fortunately, the issue of stronger corporate governance is, in theory, a policy issue that the Japanese government is concerned about.[43] In that regard, in 2010, the Ministry of Justice convened a Legisla-

Institutions and Investment Firms, COM (2011) 452 final, (July 7, 2011), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SPLIT_COM:2011:0452(01):FIN:EN:PDF.

41. *See* Press Release, Association for Financial Markets in Europe, Europe Needs an Expanded Securitization Market, says AFME Chief Executive (June 14, 2011), http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=5440.

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42. Kin'yu shohin torihiki-ho [Financial Instruments and Exchange Act], Law No. 48 of 1948, art. 24 (4), art. 193-2 (2) (amended Apr. 1, 2008) (Japan), *available at* http://www.fsa.go.jp/common/law/fie01/pdf.

43. *See* Ministry of Economy, Trade and Industry, The Corporate Governance Study Group Report (June 17, 2009), http://www.meti.go.jp/english/report/downloadfiles/200906cgst.pdf; *see also* Press Release, Financial Services Agency, Remarks by Shozaburo Jimi Minister of State for Financial Services (Nov. 11, 2011), http://www.fsa.go.jp/en/conference/minister/2011/20111111-1.html.

tive Advisory Council with the authority to consider amendments to Japan's Companies Act,[44] which would strengthen corporate governance in listed companies in Japan.[45] The Council's Companies Act Subcommittee is currently deliberating amendments to the Companies Act that would clarify and strengthen the role of "independent outside directors." This is a good start, but the review should include a serious look at other areas including: stronger delisting rules at the Tokyo Stock Exchange, increasing personnel at regulatory agencies like the Securities Exchange Surveillance Commission, and developing more robust disclosure requirements for related party and M&A transactions. While none of the above—individually or together—constitutes an ironclad framework to prevent future corporate misdeeds, it will go a long way in improving corporate governance in Japan and providing comfort to investors.

B. China

In 2011 there were several episodes of problematic or lax corporate governance in China that, at least from the perspective of Western investors, may serve as a wakeup call for improved corporate governance in listed companies with operations in China. Specifically, there have been a number of accounting scandals involving China based public companies that have listed in the United States either through a "reverse merger" structure (*e.g.*, China Agritech, Sino Forest) or via more traditional IPO methods (*e.g.*, Longtop Financial). These incidents raise a number of issues for Western investors, including issues of adequate internal controls and adequate audit functions within these companies. A different issue, the lack of transparency and the relative powerlessness of foreign shareholders, was highlighted in an episode involving the Alibaba Group's transfer of its Alipay subsidiary to a related party, allegedly without the prior consent of its largest shareholder, Yahoo! Inc. The above incidents highlight the need for a stronger regulatory framework for corporate governance in China. There has yet to be an overt effort on the part of Chinese regulators to improve the quality of corporate governance in China based public companies; but if Chinese companies want to maintain their attractiveness to foreign investors, there should be. Predictably, the initial official response has come from regulators in the United States and elsewhere. With respect to the reverse merger companies, U.S. and Canadian regulators, including the U.S. Securities and Exchange Commission (SEC) and the U.S. Public Company Accounting Oversight Board (PCAOB) have taken enforcement action on many of these cases and adopted new rules to try to deal with the problem.[46] The PCAOB is also investigating the use of "variable interest entities" (VIEs)

44. *See* Kigyo Wa Ho [The Companies Act], Law No.86 of 2005 (as amended), *available at* http://www.cas.go.jp/jp/seisaku/horei/data/CA1_4.pdf (Japan).

45. *See, e.g.*, Glass Lewis & Co., *Japanese Corporate Governance in Progress*, WORLD GOVERNANCE FOCUS Oct. 2010, at 5, *available at* http://www.glasslewis.com/downloads/1412-183pdf.

46. On November 8, 2011, the SEC approved new rules proposed by the New York Stock Exchange, the NASDAQ Stock Market and NYSE Amex that tighten the initial listing requirements for reverse merger companies. *See* SEC Release No.34-65708, WL 5434020 (Nov. 8, 2011); Exchange Act Release No. 34-65709, 2011 WL 5434021 (Nov. 8, 2011); Exchange Act Release No. 34-65710, 2011 WL 5455963 (Nov. 10, 2011); *see also* PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB), Research Note No.2011-P1, ACTIVITY SUMMARY AND AUDIT IMPLICATIONS FOR REVERSE MERGERS INVOLVING COMPANIES FROM THE CHINA REGION: JANUARY 1, 2007 THROUGH MARCH 31, 2010 (Mar. 14, 2011), *available at* http://pcaobus.org/Research/Documents/Chinese_Reverse_Merger_Research_Note.pdf.

by China based public companies.[47] The SEC's equivalent in China, the China Securities Regulatory Commission (CSRC), has not taken enforcement action to date.

The recent dispute between Alibaba and Yahoo! highlights one of the corporate governance risks inherent in the popular VIE structure for foreign investment in Chinese companies. In general, a VIE structure involves an arrangement whereby one or more foreign investors, together with one or more PRC persons or entities, form an offshore entity (HoldCo) that owns or controls an onshore wholly foreign owned enterprise (WFOE) or a similar foreign-invested enterprise (FIE) in China. The WFOE or FIE has contractual control over the ownership and management of a domestic operating company (OpCo), which holds the necessary licenses or permits to operate in a business that is subject to restrictions on foreign investment. The critical feature and perhaps flaw in VIE structures from a corporate governance perspective is that control over the OpCo is maintained through voting proxies, equity pledges, and various service agreements rather than through direct share ownership. This flaw was highlighted in the Yahoo! dispute with Alibaba. While the actual reasons for the Alipay spin-off remain unknown to the general public, the validity and the appropriateness of the use of VIE structures has been brought into question. There have been numerous situations in addition to the Alibaba case, wherein foreign investors in VIE structures have not been able to control the actual business, notwithstanding their level of share ownership or board representation on the WFOE or FIE. One significant problem is that the VIE structure does not have any official backing by the Chinese government as a legal structure, which precludes official redress. The CSRC and other government entities may be considering the appropriateness of VIEs for foreign investment. A serious look at the nature of these structures by the relevant authorities in China would be beneficial to foreign investors and the advance of corporate governance in China based public companies.

V. Germany*

A. Disclosure of Equity Derivatives

The Act for the Strengthening of Investor Protection and the Improvement of Capital Market Efficiency[48] will enhance the disclosure of equity derivatives relating to shares of listed companies and is expected to make secret stake-building in listed companies more difficult.[49] The new rules take effect on February 1, 2012, and will introduce disclosure (i) of instruments "making it possible" for their holder to acquire shares,[50] and (ii) of return

47. *See* PCAOB, Staff Audit Practice Alert No.8: Audit Risks in Certain Emergency Markets 6 (Oct.3, 2011), *available at* http://pcaobus.org/Standards/QandA/2011-10-03_APA_8.pdf.

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48. Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts [The Act for Strengthening of Investor Protection and the Improvement of Capital Efficiency] Apr. 5, 2011, BGBl. I at 538 (Ger.).

49. Harmut Krause, *Die erweiterte Beteiligungstransparenz bei börsennotierten Aktiengesellschaften* [The Extended Participation of Transperency in Listed Companies], 56 Die Aktiengesellschaft, 469, 484 (2011) (Ger.).

50. Wertpapierhandelsgesetz [WpHG] [Securities Trading Act], at 2708, § 25a last amended by Gesetz [G], Dec. 22, 2011, BDGl. I at 3044 (Ger.).

claims under securities loans and repurchase claims under repo transactions.[51] Therefore, disclosure will extend to (i) cash-settled instruments if the counterparty can hedge its risks under the instruments by holding the relevant shares,[52] and (ii) instruments providing for physical settlement even if they do not confer the right to unilaterally acquire shares.[53] The latter include physical call options subject to a condition beyond the control of the holder of the instrument, or physical put options. Disclosure is required if the underlying reaches or exceeds (or falls below) five, ten, fifteen, twenty, twenty-five, thirty, fifty, or seventy-five percent of the share capital. The hypothetical voting rights under such instruments shall be aggregated with the voting rights that are disclosable under current legislation.[54]

As a counterweight to the broad and sweeping disclosure requirements, the Federal Ministry of Finance was given authority to decree exceptions.[55] Exceptions appear to be necessary to eliminate irrelevant disclosures resulting from derivatives on baskets and indices or from hedging transactions incurred by financial service providers when closing open positions incurred for the benefit of their customers.[56] As the Ministry has not made use of such authority, it remains to be seen whether the rules in the statute master the challenge of bringing hidden ownership to light and filtering away all irrelevant disclosures.

B. Regulation affecting Investment Funds

The Act for the Transformation of Directive 2009/65/EC, the Co-ordination of Legal and Administrative Provisions Affecting Undertakings for Collective Investment in Transferable Securities[57] tightened the requirements for the management of assets[58] and for sales prospectuses,[59] and introduced a framework for (i) collective portfolio management to work cross-border on the basis of a "European Passport,"[60] (ii) the cross-border merger of investment funds,[61] (iii) "master-feeder structures,"[62] and (iv) new requirements aiming at the better information of investors.[63] The Act also introduced rules dealing with the amendment of the contractual terms of investment funds.[64]

51. According to the materials; *see* Deutscher Bundestag: Drucksachen und Protokolle [BT] 17/3628, at 19; *see also* Harmut Krause, *supra* note 49, at 475.

52. WpHG § 25a (1), sentence 2, no. 1.

53. *Id.* § 25a (1) sentence 2, no. 2.

54. *Id.* § 25a (1) sentence 6.

55. *Id.* § 25a (4) sentence 1, no. 2.

56. Krause, *supra* note 49, at 478, 482.

57. Gesetz zur Umsetzung der Richtlinie 2009/65/EG zur Koordinierung der Rechts - und Verwaltungsvorschriften betreffend bestimmte Organismen für gemeinsame Anlagen in Wertpapieren [Act for the Transformation of Directive 2009/65/EC, the Coordination of Legal and Administrative Provisions Affecting Undertakings for Collective Investment in Transferable Securities], June 22, 2011, BGBL. I at 1126 (Ger.).

58. Investmentgesetz [InvG] [Investment Act] Dec. 15, 2003, BGBL. I at 2676, §§ 9(3a)–(3b), 9a(1) no. 7–9, 36(2), last amended by Gesetz [G], Dec. 22, 2011, BGBL. I at 3044.

59. *Id.* § 42(1), (1a).

60. *Id.* §§ 12a–13a.

61. *Id.* §§ 40-40h.

62. *Id.* §§ 45a-45g.

63. *Id.* § 42(2).

64. *Id.* § 43(3).

C. Regulation of the "Grey Market"

The draft Act on the Investment of Assets[65] will introduce new requirements for investments in non-listed financial instruments (also known as the "grey market"). Once promulgated, the Federal Financial Supervisory Authority (BaFin) will check not only the completeness but also the coherence and comprehensibility of sales prospectuses.[66] Fees and costs must be disclosed in the sales prospectus in a conspicuous manner.[67] Grey capital markets products will be included in the definition of financial instruments in the Securities Trading Act,[68] with the result that business enterprises carrying on the distribution of, and certain other activities in connection with, grey capital market products will be subject to the organizational requirements applicable to securities services providers, including the prohibition of "kick-back" payments.[69] Furthermore, the period of limitation for prospectus liability claims will be extended from six months to two years.[70] When the manuscript was completed, the draft legislation was still pending in the Reconciliation Committee of the German Federal Parliament because the upper and the lower houses failed to agree on whether businesses carrying on activities in connection with grey capital market products should be supervised by BaFin or by the relevant authorities of the federal states.

VI. Peru*

In addition to the global economic crisis factor, the local political scenario also impacted the performance of the Peruvian capital markets sector. On June 5, 2011, Ollanta Humala, a left-wing former military officer, won Peru's presidential election, causing an immediate holdback on private investment. Notwithstanding, investors' confidence is slowly being restored following Humala's initial hints that his government will not deviate from existing macroeconomic policies. The appointment of independent and reputable technocrats as heads of two of the key institutions for Peruvian economy: Julio Velarde, who was ratified as chief officer of the Central Bank, and Luis Miguel Castilla, the current Peruvian Minister of Economy, contributed to boost market confidence.

65. Deutscher Bundestag: Drucksachen und Protokolle [BT] 17/7453 (Ger.) (Vermögensanlagengesetz [Investment Law], adopted by the German Federal Parliament on Oct. 27, 2011).

66. Verordnung über Vermögensanlagen-Verkaufsprospekte [VermVerkProspV] [Securities Prospectus Regulation] Dec. 16, 2004, BGBl. I at 3463, § 8 (1), last amended by Gesetz [G], Dec. 6, 2011, BGBl. I at 2481.

67. *Id.* § 4 (10)-(12). VermVerkProspV should be interpreted in connection with definitions provided in WpHG § 2. WpHG, Sept. 9, 1998, BGBl. I § 2(3), (4), and (2b), last amended by Gesetz [G], Dec. 22, 2011, BGBl. I at 3044.

68. WpHG § 2(2b), as amended.

69. WpHG § 31d(1). This section should be interpreted in connection with definitions provided in WpHG § 2(3), (4), and (2b).

70. Gesetz über Vermögensanlagen [VermAnlG] [Investment of Assets Act], Dec. 6, 2011, BGBl. I at 2481, §§ 20 (1), 21 (1).

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A number of legal developments are of note regarding Peruvian capital markets sector. First, Law No. 29720[71] (Law that Promotes the Issuance of Securities and Reinforces the Capital Market) has introduced several changes to the applicable Peruvian legal framework. Among the most relevant ones, we deem important to highlight the following:

- Law No. 29720 sets forth the objective liability of the management of a public company for the damages caused as a result of the transactions in which it was involved. Consequently, it will not be necessary to prove negligence of the management in order to declare its liability for such damages before the company or its shareholders.
- The companies that do not fall under the supervision of the Superintendency of the Securities Market (SMV) (i.e., private companies) and meet an annual sales income or have assets that equal or exceed 3,000 UIT,[72] are now obliged to present audited financial statements before the SMV. According to Law No. 29720, such financial information is publicly accessible.

Given that this measure is highly questionable, on November 9, 2011, the Committee of Economy of the Peruvian Congress approved, by majority, an opinion in favor of modifying the aforementioned rule by suppressing the public access of these financial statements. But it is uncertain if the Peruvian Congress will finally issue a law in such sense.

According to the former regulations of securities private placement, in order to avoid the qualification of a "public offering," the issuer was prevented from using mass media while advertising its offer. This requirement has been abrogated by Law No. 29720, which has, therefore, set forth the following "safe harbors" for private placements: (i) the offering of securities to "institutional investors,"[73] (ii) the offering of securities which lowest placement or nominal value equals or exceeds PEN 409,342.16,[74] and (iii) whenever the SMV expressly provides so.

Second, Law No. 29782[75] (Law of Reinforcement of the Capital Markets Supervision) turned the Business and Securities National Supervisory Commission (CONASEV) into a Superintendency (the SMV), in an attempt to strengthen its supervisory role over the agents within the scope of capital markets regulations. In such sense, Law No. 29782 has, among others: (i) granted technical, administrative and budgetary autonomy to the SMV, (ii) enabled the SMV to issue periodic penalty payments, (iii) abrogated the limit applicable to the fines issued by the SMV of ten percent of the annual income of the sanctioned company/person, (iv) reinforced the consolidated supervision of business and financial

71. Ley No. 29720, Ley Que Promueve Las Emisiones de Valores Mobiliarios Y Fortalece El Mercado de Capitales [Law That Promotes the Issuance of Securities and Reinforces the Capital Market], EL PERUANO, June 25, 2011.

72. UIT stands for *Unidad Impositiva Tributaria*, a tax reference unit. For the 2011 fiscal year, the UIT in force is PEN 3,600. *See* Decreto Suprema No. 252-2010-Ef, Valor de la Unidad Impositiva Tributaria durante el ano 2011 [Value of the Tax Unit in 2011], Sistema Peruano de Informacion Juridica, Economica y Finanzas, Dec. 11, 2010.

73. The qualification of an "*institutional investor*" falls upon, among others, the following entities: banks, financial institutions, insurance companies, brokerage firms, open-ended/close-ended investment fund managers and foreign entities that perform similar businesses.

74. This amount is updated annually using the "Wholesale Price Index for Metropolitan Lima." *See* INSTITUTO NACIONAL DE ESTADISTICA E INFORMATICA, INDICADORES DE PRECIOS DE LAW ECONOMIA, No. 02-2011-INEI (2011).

75. Ley No. 29782, Ley de Fortalecimiento de la Supervision del Mercado de Valores [Law of Reinforcements of the Capital Markets Supervision], EL PERUANO, July 28, 2011.

groups, and (v) "shielded" public officers of the SMV by subordinating the criminal complaints filed against them to the prior issuance of a technical report from the SMV.

Finally, although it does not exclusively concern the Peruvian capital markets sector, the official launching of the Integrated Latin America Market (*Mercado Integrado Latinoamericano*, "MILA") on May 30, 2011 constitutes a joint achievement of the stock exchanges from Peru, Chile, and Colombia. The MILA is a platform that enables the trading of equity securities quoted indistinctively on the Lima Stock Exchange, the Santiago Stock Exchange, or the Colombia Stock Exchange; thus, providing a wider range of investment opportunities for local agents and financing sources for public companies. Although, to date, the trading volumes of the MILA remain on a low average, experts agree that the future growth of this market seems quite auspicious.