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# A Legal Analysis on Enterprises Overseas Fundraising -- A Comparison Between the U.S. Market and the Taiwanese Market

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**A LEGAL ANALYSIS ON ENTERPRISES OVERSEAS  
FUNDRAISING—A COMPARISON BETWEEN THE U.S.  
MARKET AND THE TAIWANESE MARKET**

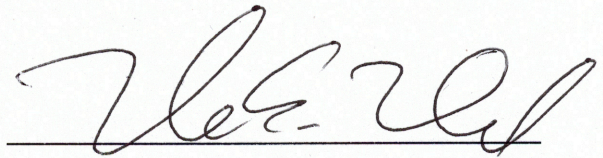
Ke Ho

Submitted to the faculty of Indiana University Maurer School of Law  
in partial fulfillment of the requirements  
for the degree  
Doctor of Juridical Science  
August 2017



Accepted by the faculty, Indiana University Maurer School of Law, in partial fulfillment of  
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April 3<sup>rd</sup>, 2017

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## Abstract

Since the 1990s, Taiwan's government has made efforts to upgrade economic development by attracting more foreign enterprises to enter the domestic capital market. However, in the early 2000s, statistics indicated that the number of such new enterprise listings in Taiwan actually decreased. Some believe a very important factor in the decrease to the number of new listings in Taiwan is the current regulatory framework's lack of flexibility. It is assumed that the regulatory intensity for foreign enterprises is very high. In order to review this intensity on the foreign issuer, this dissertation presents research on the law regulating a foreign enterprise that is conducting fundraising.

Securities regulation is one of the most important areas of law governing enterprises fundraising, as the issuance of securities is a very efficient method of raising funds in the capital markets. The research herein addresses regulatory standards of information disclosure, corporate governance, and stock market listing requirements for the domestic issuer and the foreign issuer, respectively. Once we understand the regulatory standards applicable to the domestic issuer and the foreign issuer, we can best calibrate an appropriate regulatory intensity for the foreign issuer.

In 2012, legislators amended the Securities and Exchange Act to expressly include the foreign issuer conducting fundraising under the regulatory scope of the Taiwanese law. In that law, several disadvantages exist that may present obstacles for the foreign issuer. On the other hand, the theories of international

securities that helped create a well-structured regulatory system in the U.S. has allowed the U.S. to become a primary capital market for international enterprises conducting fundraising. Hence, this dissertation intends to use the method of comparative study to analyze the differences in those legal structures between the U.S. and Taiwan. This dissertation demonstrates that the Taiwanese law could improve by imposing some of the regulatory merits of the U.S. system, adjusting regulatory intensity on the foreign issuer and reducing the downsides resulting from current regulation.



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# Chapter 1: Introduction

## I. Research Purpose and Motivation

With the policy of liberalization of capital movements and the global prevalence of financial deregulation, enterprises nowadays have opportunities to seek out overseas fundraising. With a foundation of democracy and geographical openness, Taiwan has advantages and the potential to develop itself to become a financial operational center of Asia-Pacific.<sup>1</sup> Since the 1990s, Taiwan's government has started to take liberal steps to upgrade economic development by attracting more foreign enterprises to enter the domestic capital market.<sup>2</sup> The short-term goal of Taiwan regarding increasing the listing volume is to focus on attracting the listing of enterprises operated by Taiwanese or Chinese individuals due to the historical and cultural influence of the Greater Chinese World.<sup>3</sup> A more ambitious dream of Taiwan is to fulfill the achievement of becoming a world-class capital center in the small island.<sup>4</sup>

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<sup>1</sup> Although this drew criticism, in 1993 the Taiwanese government proposed the plan of developing Taiwan to become the "Asia-Pacific Regional Operations Center." The reason behind this policy is mainly because of the unique international status and hardship of Taiwan. For the implementation of the plan by way of macroeconomic adjustments, the Taiwanese government suggested promoting trade and investment liberalization and reducing entry and exit restrictions on personnel as well as easing restrictions on capital movement. See Taiwan Asia-Pacific Regional, [http://park.org/Taiwan/Government/Theme/Asia Pacific Rigional/apc02.htm](http://park.org/Taiwan/Government/Theme/Asia_Pacific_Rigional/apc02.htm) (last visited March 20, 2017).

<sup>2</sup> *Id.*

<sup>3</sup> See Wen-yeu Wang and Christopher Chao-hung Chen, *Liberalization of Taiwan's Securities Markets: The Case of Cross-Taiwan-Strait Listings*, 26, (2) Banking and Financial Law Review 259, 276, Research Collection School Of Law (2011), available at [http://ink.library.smu.edu.sg/sol\\_research/979](http://ink.library.smu.edu.sg/sol_research/979) (last visited March 20, 2017).

<sup>4</sup> *Id.*



However, in the early 2000s, the number of listings in Taiwan decreased.<sup>5</sup> More and more enterprises have chosen to list on other neighboring Asian markets, including Singapore, Hong Kong and Mainland China.<sup>6</sup> As the number of listings in Taiwan decreases, a call to reform the regulatory framework has arisen.<sup>7</sup> Experts believe that the current regulatory framework, which lacks the flexibility and competition that neighboring countries have,<sup>8</sup> is to blame for the decrease of listing numbers in Taiwan.

Some indicate that issuers delisted from Taiwanese exchanges because the Taiwanese government made a series of special laws to restrict funds raised in Taiwan for use in investing in Mainland China, which led to many firms turning to list in Singapore or Hong Kong as their foundation for further investing in Mainland China.<sup>9</sup> Thus, scholars apply the theory of law market competition to explain this fact, suggesting that the de-listing phenomenon in recent years is a signal of demonstrating the “exit” right and “voice” right by securities issuers to leave the Taiwanese market, so that legislators should be amend the law by

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<sup>5</sup> See Comparison of World’s Major Securities Markets (Number of Listed Companies) in TWSE website, [http://www.tse.com.tw/ch/statistics/statistics\\_list.php?tm=06&stm=004](http://www.tse.com.tw/ch/statistics/statistics_list.php?tm=06&stm=004) (last visited March 30, 2017).

<sup>6</sup> See Town-Shine Wu (吳東憲), Taiwan Qiye Haiwai Chouzi Zhi Yanjiu-Jianlun Haiwai Taiwan Qiye Huitai Chouzi (臺灣企業海外籌資之研究-兼論海外臺灣企業回臺籌資) [A Study on Overseas Fundraising by Taiwanese Enterprises: With Discussion on Fundraising by Overseas Taiwanese Enterprises in Taiwan], 111 (2008) (unpublished LL.M. thesis, National Taiwan University).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> See Chang-Hsien Tsai, Law Market Forces Underlying International Jurisdictional Competition: The Case of Taiwan’s Regulatory Evolution on Outward Investment in Mainland China, 1997-2008 (2010) 123-95 (unpublished JSD dissertation, University of Illinois).

eliminating unnecessary regulatory restrictions in order to increase market competition.<sup>10</sup> Additionally, scholars apply the theories of regulatory competition and regulatory cooperation, suggesting that special laws about the restriction of the funds raised in Taiwan to be used in investing in Mainland China can be substantially amended.

This dissertation argues that the current research on regulation regarding the foreign issuers conducting fundraising in Taiwan are not comprehensive enough because they merely focus on analyzing the effect of special laws. Certainly, issuers tend to move out of an over-regulated market and enter a low-regulated market if the cost of legal compliance exceeds the interest of fundraising. However, we cannot discern whether the general fundraising law is as restrictive an obstacle to the foreign issuer entering the Taiwanese market by appearance. In other words, it is not accurate to state that the overall fundraising regulatory structure is too restrictive merely from the analysis of the special restrictions on the funds raised in Taiwan in investing in Mainland China. Therefore, this dissertation intends to explore the general fundraising law so that we are able to approach from a broad perspective to provide substantial suggestions for the future reformation regarding the area of Taiwanese capital markets.

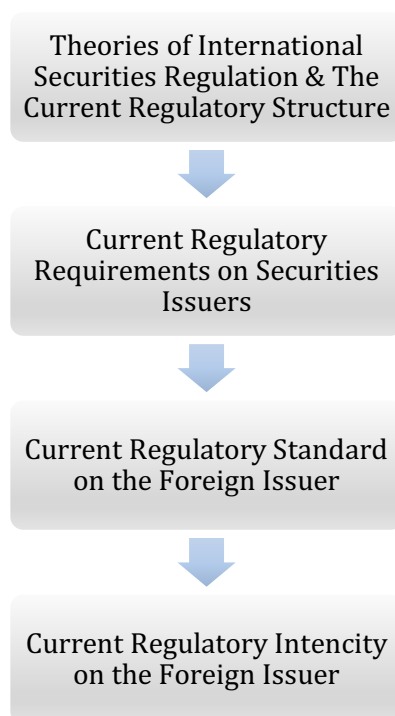
Since securities regulation is one of the most important areas of law governing enterprises fundraising, this dissertation discusses securities regulation as the general fundraising law analysis. Thus, securities regulation is

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<sup>10</sup> *Id.*

defined as the general fundraising law in this dissertation. In order to understand the securities regulatory intensity on the foreign issuer, the dissertation first studies the theories of international securities and applies those theories in examining the current regulatory direction and structure adopted by the regulators. Then, the dissertation looks into the current regulatory structure to analyze the regulatory requirements on the securities issuer. Furthermore, the dissertation compares the regulatory standards on the domestic issuer to those imposed on the foreign issuer, because the regulator may impose a different standard on the foreign issuer despite the fact that the foreign issuer may be required to follow the same regulatory requirements imposed on the domestic issuer. Once we know about the regulatory standard on the foreign issuer, we will be able to better understand the regulatory intensity on the foreign issuer. Through the process of analysis, we will realize whether the general fundraising law is too restrictive an obstacle for the foreign issuer to enter Taiwan. See Chart 1 for reference.

**Chart 1: The Roadmap of Analyzing Regulation on the Foreign Issuer**



Source: The Author

Although there are many methods international enterprises can use to conduct cross-jurisdictional fundraising, this dissertation intends to focus on the research of securities regulation on the foreign issuer in entering one jurisdiction because securities issuance is an efficient and effective fundraising method. Besides, the maturity of the theories of international securities regulation is valuable for analyzing Taiwan's current regulatory structure. In 2012, legislators amended Taiwan's Securities and Exchange Act to expressly include the foreign issuer conducting fundraising under the regulatory scope of Taiwanese law. In that law, several disadvantages exist that may present obstacles for the foreign issuer. This dissertation argues that the Taiwanese market has the potential to

become a better listing environment via regulatory improvement by applying the theories of international securities regulation to indicate the right regulatory direction as well as taking inspiration from current U.S regulation via comparative study.

## **II. Methodology of Research**

This dissertation conducts comparative studies between U.S. and Taiwanese regulations related to foreign issuers raising capital. First, the dissertation researches the theories of international securities regulation, then it surveys the U.S. and Taiwan on their current securities regulation related to the foreign issuer. Moreover, it applies the theories of international securities regulation to analyze the regulatory directions in both two jurisdictions respectively. It further compares Taiwanese regulation with U.S. regulation to find out the disadvantages existing in current Taiwanese regulation, and therefore proposes that Taiwan emulate U.S. regulation related to foreign issuers in order to increase the influx of capital and create capital markets development.

The dissertation uses U.S. law as the comparative subject matter and learning model based on a few factors.

First, the U.S. has developed a good regulatory structure after many years of foreign issuers entering its securities markets. Since nowadays the U.S. capital market has become a primary place for overseas enterprises searching for places

to raise funds, the regulatory system in the U.S. is sound and complete. U.S. securities regulation has taken various approaches to make it easier for overseas fundraising companies to issue securities in the U.S. market. Those approaches include exemption of registration on certain securities, different information disclosure standards and different financial statement standards. The reason behind these approaches is to attract more foreign enterprises to enter the U.S. capital markets, because it costs both time and money to follow the same standard as domestic companies do. However, the regulator also defines a boundary to ensure the interests of investors is not infringed-upon.

Second, U.S. academia has discussed relevant theories about the international securities regulatory philosophy for the last twenty years, boosting regulators to take fine regulatory direction for development of the capital market. These well-developed theories are the basis for examining the current regulatory structure. The current U.S. regulatory direction emphasizes investor protection, achieved through appropriate and effective regulation. However, many scholars have proposed eliminating unnecessary and additional regulation in order to create a more competitive regulatory environment. They think we should allow issuers to choose their preference of regulatory regime. On the other hand, we risk sacrificing the interests of domestic investors if we set a lenient regulatory standard for the foreign issuer. Besides, other proposed regulatory theories rebut issuer choice this something. Proponents of the bonding hypothesis find out a company listing on an overseas market will automatically bond with the regulations at that overseas market. It means the company promises to follow the regulations at that overseas market and will substantially improve its corporate

governance. Therefore, regulators should be encouraged to set up high regulatory requirements for foreign issuers listing. Moreover, based on the economic analysis, some detractors suggest mandatory regulation should be imposed on the domestic issuer. Since mandatory regulation only affects the interest of the welfare of U.S. individuals, mandatory regulation on the foreign issuer is not necessary. To sum up: the debate about the best regulatory direction is ongoing. While we apply the theories of international securities regulation in analyzing Taiwanese fundraising law, it is important to refer to how these theories analyze the U.S. fundraising law as well.

Third, the theories of the international securities regulation were originally proposed to analyze the general fundraising law because they discuss the securities regulatory standards we impose on the issuers. However, many scholars borrowed the idea from the theories of the international securities regulation to analyze special laws and restrictive measures rather than securities regulation. Often, scholars analyze the problem with only one consideration: avoiding over-regulated regimes. They may claim that regulation of the foreign issuer is too restrictive, and that regulation needs to be relaxed following the trend of deregulation and increasing regulatory competition. This dissertation believes that we should research securities regulatory standards to determine if the general fundraising law on the foreign issuer is an obstacle. This way, we can observe how U.S. scholars apply the theories to examine the securities regulatory standards on the issuers.



Fourth, Taiwanese regulatory structure is influenced by U.S. law. Legislators amended the current Taiwanese Securities and Exchange Act with reference to the U.S. Securities Act of 1933 and the Securities Act of 1934.<sup>11</sup> Modern principles of regulatory philosophy existing in U.S. regulation, such as the information disclosure principle and efficiency market theory, have inspired Taiwanese legislators to emulate U.S. law. One may debate whether the regulatory structure of a common law system, with its unique character of fifty in a continent, fits well into a totally different regulatory system with the influence of Asian history and culture. However, the advantages of U.S. regulation deriving from the modern dominate financial power in the world makes for worthwhile studying. In order to avoid conflicts and loopholes in the law, the better approach is to conduct comparative study with U.S. regulation, as the original Taiwanese regulatory structure is built on the emulation of the U.S. structure.

### III. Research Scope

This dissertation focuses on general fundraising law—that is, securities regulation rather than special restriction. In general fundraising law, the dissertation conducts the comparative study on the securities regulatory standards on issuers. The majority of Taiwanese scholars usually propose revising

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<sup>11</sup> See SYUE-MING YU (余雪明), *ZHENGQUAN GUANLI (證券管理)* 139 (2<sup>nd</sup> ed. 1981) (Taiwan); Yung-Chen Chuang (莊永丞), *Woguo Zhengquan Jiaoyi Fa Zaici Faxing Zhi Lilun Jichu Yu Guifan Queshi (我國證券交易法再次發行之理論基礎與規範缺失)[A Critique and a Proposal of Secondary Offering in Taiwan]*, 26 *ZHONGYUAN CAIJING FAXUE PINGLUN (中原財經法學評論)[Chung Yuan Financial & Economic Law Review]* 1, 7 (2011).

the law from the narrow perspective of avoiding restrictive regulation because they only concentrate on the impact of the special legal measures that bring about restrictive effect, neglecting to conduct analysis on the regulatory standards of information disclosure and its relevant obligation, which is the primary task of researching general fundraising law. To better explore the securities regulatory standards on issuers, this dissertation argues that research on the regulatory requirements is necessary. Hence, this dissertation conducts an overall examination on the requirements of the regulatory obligations as the first step toward realizing the big picture of the regulatory standards of information disclosure and relevant obligations.

#### **IV. Research Questions to be Explored**

The main issue discussed in this dissertation is the insufficiency within the current regulatory structure, which this dissertation analyzes from the perspective of comparative study on the theoretical analysis and research on current securities regulation. In the process of resolving the primary issue, this dissertation discovers and resolves many questions step-by-step. In the theoretical analysis, the dissertation investigates the regulatory philosophy and specific approaches proposed by scholars, exploring the reasons behind these proposals as well as the advantages and downsides of each theory. In researching the regulatory requirements and standards on issuers of each jurisdiction, it discovers the current regulatory directions adopted and what kind of approaches are applied to reach the regulatory directions. In comparing U.S. and Taiwanese

regulation, this dissertation will answer the question of what requires improvement in Taiwan's current regulation. How can we apply the merits of theoretical recommendations and the advantages of U.S. regulation to the current Taiwanese regulatory structure? What is the significance of the application?

## **V. Arrangement of Chapters**

The remainder of the dissertation is organized as follows.

Chapter two is the theoretical analysis and arguments of the regulatory approach on international securities regulation. It analyzes the theories of international securities regulation proposed by U.S. scholars, suggesting different regulatory directions for U.S. regulators via different approaches with persuasive reasons. Since different theories were proposed from diversified angles due to the complexity of securities regulation, the debate over what constitutes the best regulatory approach is still ongoing. This dissertation would like to summarize the pros and cons of each theory as the basis to observe the merits and insufficiency of current regulation as well as advocating for the future regulatory reformation.

Chapter three surveys current regulation on foreign issuer listings in the U.S., analyzing regulatory requirements and standards. With this survey, we can learn what kind of theoretical regulatory direction and approach is adopted by the U.S. regulators in practice. We can also find out how the regulatory approach is

realized in the statutory provisions and regulatory rules together to establish a concrete and complete securities regulatory system.

Chapter four covers current regulation on foreign issuer listings in Taiwan. Since the regulatory structure of Taiwan emulates the structure of the U.S., this dissertation examines whether Taiwanese regulation contradicts the regulatory philosophy of the U.S. or if current Taiwanese regulation has developed unique characteristics that are beneficial for future development, making it appropriate in its jurisdiction and market environment. This dissertation also analyzes regulatory requirements and standards as the basis of comparison with U.S. regulation.

Chapter five compares regulation between the U.S. and Taiwan and offers suggestions for the future reformation on Taiwan regulation. The chapter first summarizes the similarity and difference between the two jurisdictions; then it points out the insufficiency of current Taiwanese regulation as compared to current U.S. regulation, including a theoretical perspective to analyze the current status quo and indicate a potential regulatory route for Taiwan. Finally, this chapter presents concrete suggestions for the future reformation based on the previous analysis.

Chapter six is the conclusion of this dissertation.

## **Chapter 2: Theoretical Analysis and Advocating for the Regulatory Approach on International Securities Regulation**

### **I. Overview**

The trend of globalization accelerates the effect of capital mobility. Businesses thus have more opportunities conducting fundraising in another jurisdiction. When a foreign issuer enters the domestic market, it has to pay high costs to comply with the unfamiliar regulatory regime. Sometimes the high cost of legal compliance will prevent the foreign issuer from entering the domestic market. However, in order to attract foreign issuers conducting fundraising, the domestic regulator then encounters the issue of looking for a good regulatory approach in order to increase competition. Since the U.S. market has become the primary place for foreign issuers conducting fundraising, U.S. scholars suggest a variety of regulatory approaches. So far, there is no consensus regarding international securities regulation. Scholars in the U.S. academic field have debated the ideal regulatory approach for a long time.

This dissertation introduces the theories of international securities regulation proposed by U.S. scholars. Theoretically, the approaches of international securities regulation can be analyzed from certain perspectives to indicate different directions. This dissertation divides the theoretical analysis of regulatory approaches into three major directions based on the value of interests

for which they are perusing. First, traditional regulatory philosophy emphasizes investor protection. Mandatory regulation of the issuers is necessary whether the issuer is domestic or foreign if their securities transaction influences the interest of domestic investors. However, regulators tend to take some special measures on behalf of foreign issuers in order to attract the volume of listing. Regulators then attempt to reconcile the interests between the foreign issuer and the domestic issuer. Secondly, liberal observers focus on the improvement of regulatory competition. They believe there should not be a monopoly regulatory power in the market; rather, they suggest letting issuers choose their preference of regulatory regime instead of sticking to the traditional U.S. dominant regulatory ideology. Finally, there is a proposal from the economic view, suggesting that regulation should pursue the best efficiency by imposing mandatory regulation based on the issuer's nationality. Thus, it is necessary to impose mandatory regulation on the domestic issuer, whereas it is not important to impose mandatory regulation on the foreign issuer.

## **II. Investor Protection as the Regulatory Direction**

Investor protection is the priority task in securities regulation from the traditional perspective.<sup>12</sup> In order to offer investor protection, the regulator must impose strict information disclosure obligations on the issuer who intends to join the securities market, because the securities market suffers from a severe

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<sup>12</sup> See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 673-74 (1984); George A. Akerloff, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

information asymmetry.<sup>13</sup> In order to fully inform the investors about the securities before making the transaction, it is necessary to impose the issuer to fulfill a series of information disclosure obligations, including securities registration and ongoing reporting regarding its securities and its company. U.S. regulation typically stresses observing whether the transaction of the securities directly influences the interests of U.S. investors.<sup>14</sup> Whether the issuer is domestic or foreign, the issuer has to fulfill the U.S. regulatory disclosure obligation if the issuer's securities transaction results in the impact of the benefit of the U.S. investor.

However, the obstacle the foreign issuer faces is that the foreign issuer is unfamiliar with U.S. disclosure obligations, so the research on relevant U.S. rules is costly. Also, U.S. securities disclosure obligations are some of the most demanding in the world, so the foreign issuer has to pay high costs to follow a variety of tedious disclosure requirements.<sup>15</sup> The situation may become worse in the situation of cross-listing, when the issuer has to comply with U.S. disclosure requirements as well as the requirements of its original listed jurisdiction.

Since the compliance price of the high disclosure obligations is high for the foreign issuer, it contributes to a substantial obstacle on the foreign issuer to enter the U.S. market. However, since the U.S. hopes to maintain its dominant role as a

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<sup>13</sup> *Id.*

<sup>14</sup> The rules on the exemptions of securities registration clearly demonstrate this idea. *See* later discussion in this dissertation: Chapter 3, a. Exempted Transaction.

<sup>15</sup> *See* James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, 55 *LAW & CONTEMP. PROBS.* 157, 159-65 (1992).

primary securities market, regulatory standards were reformed to attract foreign issuers. While we still stick to the topic of domestic investor protection, scholars propose certain regulatory approaches from different angles.

## **1. Adopting Inconsistent Regulatory Standards between the Domestic Issuer and the Foreign Issuer**

The strict information disclosure standard of the U.S. creates a very high threshold for foreign issuers to enter the U.S. market. For example, the high cost of regulatory compliance forced Nestle—a Swiss company—to give up listing in the U.S securities exchange; they turned to the pink sheet instead.<sup>16</sup> Facing the pressure of losing the volume of the foreign issuer listing in the U.S. securities market, some suggested implementing different regulatory standards or accepting foreign regulatory standards.<sup>17</sup> In other words, the U.S. should adopt inconsistent regulatory standards between domestic and foreign issuers.<sup>18</sup> However, this introduces issues regarding comparability and fairness; there will be not a comparable standard in the securities market.<sup>19</sup> For example, if the U.S

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<sup>16</sup> See Nicholas G. Demmo, *U.S. Securities Regulation: The Need for Modification to Keep Pace with Globalization*, 17 U. PA. J. INT'L L. 691, 711-13 (1996). See also James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 FORDHAM INT'L L. J. 558, S61 (1994) S61

<sup>17</sup> See Demmo, *id.* at 710. How to best strike a balance of interest between the domestic issuer and the foreign issuer is open to discussion. See also James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200 (1999).

<sup>18</sup> *Id.*

<sup>19</sup> See John C. Coffee, Jr., *The Future As History: The Prospects for Global Corporate Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 692-97 (1999).



allows the foreign issuer adopting the IFRS accounting standard in the U.S., it will be difficult to identify and distinguish the U.S. GAAP adopting issuer from the IFRS adopting issuer.<sup>20</sup> Additionally, since there would be a lenient standard on the foreign issuer, the domestic issuer would claim that treatment between the foreign issuer and domestic issuer is unequal.<sup>21</sup>

Commentators argue over comparability and fairness. Even if we set up a uniform standard, it will be difficult to compare one to another between the domestic issuer and the foreign issuer because different countries follow different business customs.<sup>22</sup> From the investor protection perspective, the mandatory regulatory standard will force the foreign issuer to enter less-regulated markets, and it is unfavorable for investors.<sup>23</sup> Also, there is evidence that the foreign issuer will voluntarily provide sufficient information to investors in the domestic market. For example, the Nestle company used to trade in the pink sheet market and thus was not required to make significant disclosure. But Nestle voluntarily disclosed more information to investors, and thus eventually increased its volume of trading in the U.S. market.<sup>24</sup> As for the rebuttal to the unfairness to the domestic issuer, it is not clear if allowing the foreign issuer with a different disclosure standard, such

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<sup>20</sup> *See id.*

<sup>21</sup> Demmo, *supra* note 16, at 710. *See also* Richard C. Breeden, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation*, 17 FORDHAM INT'L L. J. S77, at S87-90 (1994).

<sup>22</sup> Demmo, *supra* note 16, at 715.

<sup>23</sup> *See James L. Cochrane, Are U.S. Regulatory requirements for Foreign Firms Appropriate?*, 17 FORDHAM INT'L L.J. S58, S61 (1994).

<sup>24</sup> Demmo, *supra* note 16, at 717.

as a disclosure standard without U.S. GAAP reconciliation, will prejudice the interest of the domestic issuer, because the foreign issuer and the domestic issuer come from substantially different business practices.<sup>25</sup> Furthermore, the U.S. issuer is often allowed to use its original disclosure standard, such as U.S. GAAP, to enter a foreign market. Therefore, it is fair to allow the foreign issuer to follow an inconsistent regulatory standard in the U.S.<sup>26</sup>

Commentators suggest that the U.S. should accept different regulatory standards towards the domestic issuer and the foreign issuer respectively. Specifically, legislators should create two sets of listing systems to cater to the needs of the foreign issuer without losing domestic investor protection as well. First, a foreign issuer who has sufficient company scale and capability should be regarded as a world-class company. World-class companies should be allowed to trade on the U.S. exchanges directly but only if they include institutional investors who are sophisticated enough to invest them.<sup>27</sup> Second, the U.S. should clearly define the domestic market and the foreign listing market on the U.S. exchanges that retail investors are able to access.<sup>28</sup> With the definition of such a fine line, we can offer protection for retail investors.<sup>29</sup>

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<sup>25</sup> *Id.* at 720. After all, Demmo argues that “any slight unfairness is justified in order to preserve the U.S. competition position and permit U.S. investors greater access to foreign securities.”

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 721.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

## **2. Creating a Different Regulatory Standard for the Foreign Issuer by Defining the Minimum Protection of the Domestic Investors**

Current U.S. securities regulation provides a one-size-fits-all standard to the foreign issuer.<sup>30</sup> In order to make the foreign issuer flexible, some scholars suggest creating a different standard for the foreign issuer by defining the minimum protection on domestic investors.<sup>31</sup> Since investor protection is the priority task in securities regulation, the regulator should find out a bundle of minimum and desired necessary investor interests, and thus set a threshold level of regulation.<sup>32</sup> On the premise of minimum protection with that threshold regulatory level, the regulator may divide foreign issuers into two different groups: those who come from a high regulatory regime and those from a low regulatory regime.<sup>33</sup>

For foreign issuers who hail from a high regulation regime, the U.S. regulator should not impose any significant regulation because in their own country, the

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<sup>30</sup> See Steven M. Davidoff, *Regulating Listings in a Global Market*, 86 N.C. L. REV. 89, 97 (2007).

<sup>31</sup> *Id.* at 160.

<sup>32</sup> *Id.* at 154-60.

<sup>33</sup> *Id.* at 154-55. (“The SEC should consequently craft a regulatory norm that simultaneously fulfills investors’ base interests and maximally frees the U.S. stock markets to compete and attract non-U.S. issuers. This would generally result in the following conclusion: for non-U.S. issuers who already are regulated by middle or high regulatory regimes, the SEC should adopt a free-listing regime. Non-U.S. issuers who are so regulated should be permitted to list without significant regulation in the U.S. market. The reasons are simple. These issuers are already regulated in their home market to a sufficient degree. Their home country regulation and the existence of a substantive enforcing regulator provide the core rights that investors desire.”).

issuers already experience a high degree of regulation similar to that of the U.S. disclosure standard, which effectively protects U.S. investors.<sup>34</sup> The regulations of their own country provide domestic investors with sufficient protection regarding their substantial interests. Hence, any additional regulation that exceeds the minimum threshold will lead to a great obstacle for these issuers, depriving domestic investors of investment opportunities as well.<sup>35</sup>

Conversely, U.S. regulators should impose a higher level of regulatory standard—one as similar to those disclosure obligations imposed on domestic issuers as possible—on issuers who come from a country with a lenient regulation regime or without a primary listing, because the issuers are usually not well-regulated in their own country to a level that reaches the minimum standard of U.S. investor interest protection.<sup>36</sup> Still, it is possible for the foreign issuers from a high regulation regime to comply voluntarily with the higher level of the U.S. disclosure obligation whenever the foreign issuers intend to bond with U.S. regulation.<sup>37</sup>

### **3. Methods of Creating a Consistent Regulatory Standard between the Domestic Issuer and the Foreign Issuer**

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<sup>34</sup> *Id.* at 155.

<sup>35</sup> *Id.* (“Therefore, any significant SEC regulation over and above this threshold may inhibit listings by these non-U.S. issuers.”).

<sup>36</sup> *Id.* at 161.

<sup>37</sup> *Id.*

Conservative observers would like to stick to the basic principle that the issuer, whether domestic or foreign, is required mandatory regulation under the uniform standard if the securities transaction influences the domestic investors so that we can fulfill the goal of domestic investor protection. Therefore, regulators should impose mandatory regulation on issuers relying on either the securities transaction location or investor residency.<sup>38</sup> The transaction location method suggests that the issuer is required regulation if securities transactions are effective in the U.S.,<sup>39</sup> while the investor residency approach claims that the issuer is required regulation if the investors transacting the securities are U.S. residents.<sup>40</sup>

Certain theories recommend regulation on the foreign issuer consistent with the same regulatory standard imposed on the domestic issuer, reinforcing the idea of investor protection. Subject(s) Professor Coffee discusses the study of “Bonding Hypothesis” from the perspective of the cross-listing motivation and the maintenance of the securities market reputation, arguing that mandatory

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<sup>38</sup> See Merritt B. Fox, *The Securities Globalization Disclosure Debate*, 78 WASH. U.L. Q. 567, 567-70 (2000).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* In the article, Professor Fox divides the theoretical approaches of securities regulation into five basic categories including (1) Issuer Nationality, (2) Transaction Location, (3) Investor Residency, (4) Internationality Uniformity, and (5) Issuer Choice. Professor Fox claims that the current U.S. approach of practice consists of a mix of (1) Issuer Nationality, (2) Transaction, and (3) Investor Residency. While the approach of Issuer Nationality is not obvious, this dissertation believes that the current U.S. practice focuses on investor protection via the approaches of Transaction Location and Investor Residency. Chapters Three and Five provide further discussion.

regulation to both domestic and foreign issuers is necessary.<sup>41</sup> Additionally, other scholars suggest implementing regulatory harmonization to reach the goal of reducing multiple regulatory compliance with a uniform regulatory standard that applies not only to the domestic and foreign issuers within one country, but also to those existing across other nations.<sup>42</sup>

## (1) Bonding Hypothesis

Some scholars promote the “bonding hypothesis”, which states that the motivation of cross-listing is not only to resolve the problem of market segmentation but also to search for a better regulatory regime that the issuer can bond with in order to improve the corporate governance.<sup>43</sup> Thus, if a company plans to go for an overseas listing, the overseas listing voluntarily bonds the company with the law of the listing jurisdiction.<sup>44</sup> In other words, by listing overseas, a company promises its investors in the listing place will follow the regulatory regime of the listing jurisdiction.<sup>45</sup> By complying with the strict

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<sup>41</sup> See Coffee, *supra* note 19 at 641-708. See also Rene M. Stulz, *Globalization, Corporate Finance, and the Cost of Capital*, 12(3) *Journal of Applied Corporate Finance* 8, 8-25 (1999); Oren Fuerst, A Theoretical Analysis of the Investor Protection Regulations Argument for Global Listing of Stocks (1998)(unpublished working paper); Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, unpublished working paper (1999); Larry E. Ribstein, *Cross-listing and Regulatory Competition*, 1 *REV. L & ECON.*, No. 1, ART. 7, 139 (2005).

<sup>42</sup> See Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 *MICH. J. INT'L L.* 207, 261-65 (1999); Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 *COLUM. BUS. L. REV.* 241 (1997).

<sup>43</sup> See *supra* note 41 .

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

regulatory regime of the listing jurisdiction, the company will substantially improve its corporate governance. Empirical research suggests that when issuers cross-list in a high regulation regime, they obtain abnormal returns compared to those who cross-list in a low regulation regime.<sup>46</sup> In addition, even exemptions and relaxed rules such as Rule 144A and Regulation S provide the foreign issuer with ways to avoid current U.S. regulatory requirements, issuers who adopt lenient rules obtain fewer returns than issuers who comply with stricter requirements.<sup>47</sup> Following the idea of bonding hypothesis, the regulator should maintain a high disclosure regulatory standard in order to attract cross-listing issuers for listing. The U.S. market could enhance competition if the regulator maintains a high regulatory standard, and the foreign issuer may improve its corporate governance to attract more investors as well. Besides, from the prospective of U.S. investor protection, the issuer who does not incorporate in the U.S. brings about higher risk to investors than the issuer incorporating in the U.S. Therefore, there is no reason not to impose the same regulatory standards on foreign and domestic issuers. Professor Coffee suggest that the regulator should at least depend on the issuer's trading volume to determine the regulatory scope, which means that mandatory regulation is necessary if the trading volume of the issuer is high.<sup>48</sup>

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<sup>46</sup> Darius P. Miller, *The Market Reaction to International Cross-Listings: Evidence from Depository Receipts*, 51 J. FIN. ECON. 101, 111-17 (1999).

<sup>47</sup> John C. Coffee, Jr., *Racing Towards The Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1787 (2002).

<sup>48</sup> *Id.* at 1822-1824: Professor Coffee suggests that whether U.S. listing standards should be imposed on the foreign issuer depends on its volume of trading in the United States.

However, others criticize the bonding hypothesis. Some evidence suggests that the purpose of crossing-listing is to avoid the over-regulated disclosure standard in the issuer's home country—for example, Professor Licht indicates that many Israeli companies considered listing in the U.S. market in order to avoid the high cost of disclosure standard in Israel.<sup>49</sup> Hence, the so-called “Avoiding Hypothesis” to rebut bonding comes into play.<sup>50</sup> Certainly, foreign issuers can enhance their corporate governance by bonding with a high regulation regime. However, in order to attract foreign issuers, the U.S. has developed many lenient rules for foreign issuers to “avoid” strict regulation.<sup>51</sup> Foreign issuers are, in fact, easily able to obtain exemptions from the disclosure obligations of the current U.S. regulatory system.<sup>52</sup> For instance, there are two sets of registration and ongoing report standards.<sup>53</sup> Foreign issuers adopt Form 20-F, as opposed to applying for Form 10-K which the domestic issuer uses.<sup>54</sup> As a result, foreign issuers are exempt from many corporate governance requirements.<sup>55</sup> Furthermore, Rule 3a-12 exempts the foreign issuer from proxy statements, and the issuer does not have to submit certain important information under Regulation FD.<sup>56</sup> Some

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<sup>49</sup> See Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding ?*, 4 CHI. J. INT'L L. 141, 162 (2003).

<sup>50</sup> *Id.* at 151.

<sup>51</sup> *Id.* at 151-53.

<sup>52</sup> *Id.* See also Coffee, *supra* note 47 at 1781-82. (“Although U.S. exchanges do impose significant corporate governance requirements on domestic firms that regulate board structure and protect shareholder voting rights, they have largely waived these substantive corporate governance requirements in the case of foreign issuers.”).

<sup>53</sup> Licht, *id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*



commentators even suggest that the amendment of Sarbanes-Oxley has only a limited amount of impact on the foreign issuer since the foreign issuer only applies to one out of the three rules.<sup>57</sup>

## **(2) Regulatory Harmonization**

In order to resolve the regulatory inconsistency between domestic and foreign issuers, some scholars suggest that regulators in different nations should cooperate to standardize the different regulatory regimes, developing a set of commonly accepted regulation in the international world;<sup>58</sup> thus, the International Organization of Securities Commissioners (“IOSCO”) was founded to promote regulatory cooperation, harmonization and mutual recognition among different jurisdictions.<sup>59</sup>

Nations with close economic relations and similar regulatory frameworks sign treaties to accomplish mutually accepted regulations. For example, under the Multi-Jurisdiction Disclosure System (“MJDS”) the U.S. and Canada have an agreement to accept each other’s disclosure standard. Canadian issuers may sell their securities in the U.S. by following Canada’s registration requirement without having to comply with U.S. securities regulation.<sup>60</sup> Additionally, regional nations

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<sup>57</sup> Coffee, *supra* note 47, at 1824-27.

<sup>58</sup> *Supra* note 42.

<sup>59</sup> HAL S. SCOTT ET AL., INTERNATIONAL SECURITIES REGULATION, 31 (2002).

<sup>60</sup> *Id.* at 46.

may establish a solid super-national entity to reach the goal of regulatory harmonization, such as when the Treaty of Rome facilitated the formation of the European Union. The European nations started to integrate their political and economic power after the enactment of the European Constitution.<sup>61</sup> Later, the member states of the European Union came to accept a uniform securities regulatory standard,<sup>62</sup> so that each state of the European Union only has to follow one commonly accepted standard, saving time and cost to reconcile diversified regulatory requirements.<sup>63</sup>

However, the concept of regulatory harmonization results in “regulatory cartelization”;<sup>64</sup> in other words, a country with strong international political power may promote its regulatory philosophy to other countries and pressure those countries to accept its regulatory idea.<sup>65</sup> For example, the Securities Exchange Committee (“SEC”)—the U.S. regulator—introduced U.S. regulations for insider trading to European countries, encouraging those countries to accept said regulations.<sup>66</sup> Consequently, regulatory harmonization leads to the cartel phenomenon in the international securities market.<sup>67</sup> Some voice criticizes

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<sup>61</sup> See Manning Gilbert Warren III, *The Harmonization of European Securities Law*, 37 INT’L LAW. 211 (2003), introducing how the European Union develops harmonization of legal system among its member states.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> See Jonathan R. Macey, *Regulatory Globalization as a Response to Regulatory Competition*, 52 EMORY L.J. 1353, 1361-1367 (2003).

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

IOSCO's proposals to harmonize the disclosure standard, stating that these proposals rely too heavily on the basis of the current U.S. requirements.<sup>68</sup> Even though IOSCO suggests formulating a common prospectus for the convenience of cross-border offering and listing, it is believed that the content of the proposed prospectus basically copies the requirements of U.S. information disclosure Form 20-F.<sup>69</sup>

### III. Regulatory Competition as Regulatory Direction

Liberal voices suggest abandoning the uniform standard of the regulatory structure from the perspective of increasing competition among different regulatory regimes by proposing the idea of regulatory competition,<sup>70</sup> indicating that the unilateral regulatory approach is outdated and improper<sup>71</sup> and arguing that the regulator should remove the regulatory monopoly power in order to eliminate unnecessary and inefficient regulation by improving regulatory competition.<sup>72</sup> Under regulatory competition, Professor Romano claims the

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<sup>68</sup> SCOTT ET AL., *supra* note 59 at 31. See also Marcelle Joseph and Margaret Tahyar, *How to Meet the SEC's New Form 20-F Rules*, 20 INT'L FIN. L. REV. 14 (2001).

<sup>69</sup> *Id.*

<sup>70</sup> See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L. J. 2359 (1998); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES IN LAW 387 (2001); Stephen Choi & Andrew Guzman, *Portable Reciprocity: Rethinking The International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998). The idea of regulatory competition was first proposed by Professor Tiebout. See Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 426 (1956).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

suggested unilateral approaches, such as transaction place or issuer's nationality, are improper because they obstruct the mobility of capital movement and restrict the market development from racing to the top.<sup>73</sup>

## **1. Establishing Multi-Regulatory Standards via the Issuer Choice Approach**

Professor Romano proposes establishing a market-oriented regulatory framework with the issuer choice approach.<sup>74</sup> Specifically, issuers in the securities market are entitled to choose their own preference of regulatory regimes. This way, issuers have the ability to choose the law to govern their transactions.<sup>75</sup> Allowing issuers to select the regulatory regime with high disclosure obligations in a low disclosure jurisdiction can increase the price of securities and attract investment, whereas regulators would just cater for specific interest groups if adopting the regulatory structure of a single standard.<sup>76</sup>

The idea of regulatory competition comes from the chartered competition of the 19<sup>th</sup> century, when the increased mobility of corporations resulted in the adoption of the "internal affairs doctrine."<sup>77</sup> The internal affairs doctrine gives

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<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> Choi & Guzman, *id.* at 907.

<sup>76</sup> *Id.* at 950.

<sup>77</sup> Erin Ann O'Hara & Larry E. Ribstein, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 662-65 (2008).

companies an opportunity to choose the corporate statute of the state in which the corporation is incorporated.<sup>78</sup> As a result, it motivates states to attract incorporation by improving the quality of corporate statutes to charter for the need of corporations.<sup>79</sup>

The chartered competition brings about a significant meaning to develop the securities regulatory competition theory. Since the formation of globalization, issuers are able to move freely in different securities with different regulatory regimes.<sup>80</sup> If an issuer finds that a regulatory regime impedes its fundraising—for example, perhaps the legal compliance is too high—the issuer will move to another market with a more satisfactory regulatory regime by exercising the “exit right” to avoid the high cost of complying with originally improper regulation.<sup>81</sup> Whenever there is a moving-out effect in one jurisdiction, the issuers who remain in the jurisdiction but oppose the high cost of compliance would exercise the “voice right” together with their “exit right” to pressure the regulator into reforming the law.<sup>82</sup>

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.* at 675-85.

<sup>80</sup> See WOLFGANG KASPER & MANFRED E. STREIT, INSTITUTIONAL ECONOMICS: SOCIAL ORDER AND PUBLIC POLICY 344 (1998); Mihir A. Desai, *The Decentering of the Global Firm*, 32 *WORLD ECON.* 1271, 1271-72 (2009).

<sup>81</sup> Regulated subjects respond to the regulator by exercising “exit right” as well as “voice right.” See ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1970). Regarding the discussion about exercising of exit right under federalism, see Richard A. Epstein, *Exit Rights under Federalism*, 55 *LAW. & CONTEMP. PROBS.* 147, 149 (1992).

<sup>82</sup> HIRSCHMAN, *id.* For further discussion about the cross-exercise of exit right and voice right, see Erin A. O’Hara & Larry E. Ribstein, *Rules and Institutions in Developing a Law Market: Views from the U.S. and Europe*, 82 *TUL. L. REV.* 2147, 2155 (2008).

In order to attract issuers for listing, regulators in different regimes will compete with each other by improving proper regulation.<sup>83</sup> Regulatory competition helps to create a competitive mechanism that makes regulatory authorities improve regulatory quality as well as removing unnecessary and inefficient regulation.<sup>84</sup> Afterwards, the law will substantially improve due to the competitive mechanism.<sup>85</sup>

Initially, the advocate of the regulatory competition compares the issuer's choice of regulatory regime of American state-based regulation with the way that corporations choose the corporate statute of the state in which the corporate is incorporated.<sup>86</sup> However, critics argue that the regulatory regime is restricted to the same statute as the corporate is incorporated.<sup>87</sup> Besides, we can hardly promote the choice of regulatory regime into the international world when different regimes around the world should also be taken into consideration.<sup>88</sup> As a result, scholars suggest lifting the idea of regulatory competition into an advanced level of the "reciprocity agreements."<sup>89</sup> Scholars explain that

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<sup>83</sup> The discussion of the cross-exercise of exit right and voice right triggering regulatory competition, see ERIN A. O'HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* 65 (2009).

<sup>84</sup> *Id.* at 191-99.

<sup>85</sup> *Id.*

<sup>86</sup> See Romano, *supra* note 71, at 2383-88.

<sup>87</sup> See Choi & Guzman, *supra* note 71, at 947-48.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 907, n.60.

reciprocity agreements can develop into two types—“normal reciprocity” and “portable reciprocity”.<sup>90</sup>

According to scholars, a normal reciprocity is the idea that a country allows a foreign issuer to conduct securities transactions in its domestic market while complying only with the regulatory regime of the issuer’s own country.<sup>91</sup> Usually, normal reciprocity occurs in countries with very similar regulatory structures.<sup>92</sup> Since there is no big concern about investor protection under similar regulatory structures, it will save the compliance cost if the issuer is required to comply only with the regulatory regime of the issuer’s own country. The MJDS agreement between the U.S. and Canada is a good example.<sup>93</sup>

Portable reciprocity is an even more advanced idea. Under portable reciprocity, the issuer may choose any regulatory regime of any country joining the agreement regardless of the location of the securities transaction.<sup>94</sup> For example, under portable reciprocity, a Taiwanese company could choose English law to govern its securities offering in the U.S. market.<sup>95</sup> Portable reciprocity

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<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 918-21. See also Manning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT’L L. J. 185, 192 (1990); David S. Ruder, *Reconciling U.S. Disclosure Practices with International Accounting and Disclosure Standards*, 17 NW. J. INT’L L. & BUS. 1, 11 (1996).

<sup>93</sup> Choi & Guzman, *id.* at 920. Ruder, *id.*

<sup>94</sup> Choi & Guzman, *id.* at 907.

<sup>95</sup> *Id.*

provides great flexibility to issuers as well as investors. With the opportunity to choose the preference of regulatory regime, issuers will identify themselves based on the preferred regimes.<sup>96</sup> Investors will be able make investments on issuers with different regulatory regimes. Different regimes will attract different investors. Hence, the price of the securities will decrease when the issuer chooses the low disclosure regulatory regime, while the price of the securities will increase when the issuer chooses the high disclosure regulatory regime. Investors will discount the price they are willing to pay for securities based on the issuers' chosen regimes.<sup>97</sup>

The greatest concern about portable reciprocity is that it will lead to great confusion for investors.<sup>98</sup> Since there are issuers with different nationalities choosing different regulatory regimes, critics believe there is too much information regarding regulatory regimes in the market, which results in a sort of information overload.<sup>99</sup> However, commentators provide arguments to eliminate the concern.<sup>100</sup>

First, scholars believe that investors investigate companies and markets before making investments.<sup>101</sup> Investors will realize the extent of protection

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<sup>96</sup> *Id.* at 950.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 924-25.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 925 (“The market will take into account the value of the securities law.”); see also J. William Hicks, *Securities Regulation: Challenges in the Decades Ahead*, 68 *IND. L.J.* 791, 794 (1993).



extended to the regulatory regime based on the securities price—in other words, the price of securities reflects the extent of protection.<sup>102</sup> A low price of securities reflects low protection with low information disclosure, whereas a high price of securities reflects high protection with high information disclosure.

In addition, one country may contain only a certain amount of regulatory regimes for a couple of reasons.<sup>103</sup> Since investors in reality may have limited resources to learn about and follow the regulatory regimes of only limited jurisdictions,<sup>104</sup> the market price of those securities with regimes unknown by investors will go down.<sup>105</sup> So issuers will not choose to follow the regimes unknown by investors. Also, issuers that choose a particular law of a country tend to sell securities in that country because it is easier to increase transaction volume.<sup>106</sup>

Last, the issuer selecting a regime with more investor protection has high motivation to signal its choice of law to investors.<sup>107</sup> Since the issuer pays a high compliance cost, the issuer will make effort to attract more investors.<sup>108</sup> Hence,

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<sup>102</sup> Choi & Guzman, *id.*

<sup>103</sup> *Id.* at 925.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.* at 926.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

investors are likely to identify the issuers with strong investor protection regimes from those with weak investor protection regimes.<sup>109</sup>

Commentators further explore the advantages of portable reciprocity from the views of investor protection and market function reinforcement,<sup>110</sup> stating that we should impose the issuer with information disclosure obligations because sufficient information encourages investors to make correct and proper investment judgment.<sup>111</sup> Excess regulatory obligations, on the other hand, will create pressure on the issuer so that the issuer then will transfer the cost of such legal compliance to the investors.<sup>112</sup> Portable reciprocity is an approach of regulatory competition where the issuer and investor do not have to undertake unnecessary regulatory cost.<sup>113</sup> Under such a mechanism, sophisticated investors may conduct transactions in the market efficiently,<sup>114</sup> while unsophisticated investors may rely on the stock price in the market to decide the extent of protection.<sup>115</sup>

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<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 941-45.

<sup>111</sup> See John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722 (1984).

<sup>112</sup> See Choi & Guzman, *supra* note 71, at 942.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

Regarding the maintenance of the market function, portable reciprocity can achieve the goal of reinforcing market confidence in substantial ways.<sup>116</sup> For one thing, portable reciprocity gives investors and issuers a chance to avoid heavy regulation in a country with excessive and unnecessary regulation.<sup>117</sup> For another, the issuer may select a regime with better disclosure obligations to obtain the confidence of investors in a low investor protection country.<sup>118</sup>

## **2. Critiques on Issuer Choice from the View of Uniform Regulatory Standard**

Regulatory competition argues in favor of allowing different regulatory standards in the securities regulatory field. Hence, it always raises criticism from voices supporting a uniform regulatory standard. In addition to the concern that the issuer choice of regulatory regime will lead to confusion, critics are afraid the competition among regulators intending to adopt lenient regulatory standards catering for issuers will result in a “race-to-the bottom” effect of low regulatory quality.<sup>119</sup>

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<sup>116</sup> *Id.* at 944-45.

<sup>117</sup> *Id.* at 945.

<sup>118</sup> *Id.*

<sup>119</sup> Whether issuer choice would lead to a “race-to-the bottom” or a “race-to-the-top” effect is a debatable question. *See, e.g.,* Choi & Guzman, *supra* note 71 at 916; Luca Enriques & Martin Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, 81 TUL. L. REV. 577, 579 (2007); Michael Abramowicz, *Speeding Up the Crawl to the Top*, 20 YALE J. ON REG. 139, 159-68 (2003); some scholars argue issuer choice would result in a race-to-the-top. *See* Romano, *supra* note 71, at 2383-88; Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105

Furthermore, critics argue that a uniform regulatory standard can create a network “externality” effect, which will attract more issuers in addition to benefitting the securities exchange development.<sup>120</sup> Specifically, these critics analyze the “externality” effect using the factors of “comparability”, “economic development” and “reputational brands”.<sup>121</sup>

Regarding comparability, since investors compare different stocks in the market rather than evaluating individual stocks in isolation, it is desirable to make a set of common standards and rules for investors to rely on.<sup>122</sup> Conversely, under the framework of regulatory competition, a company incorporated in one country may adopt three different disclosure standards from three different regimes. Even though each set of disclosure standards is internally consistent, these standards

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HARV. L. REV. 1435, 1435 (1992). Professor Choi and Guzman claim that Professor Merritt B. Fox believes issuer choice would lead to a race-to-the bottom result. *See* Choi & Guzman, *id.* at 948-50. However, Professor Fox clarifies his point, arguing that his concern about the consequence of “race-to-the bottom” derives from his comment on the current U.S. regulatory approach by way of transaction place. On the contrary, Professor Fox points out his critique about issuer choice is that issuer choice cannot reach the optimal social welfare. *See* Fox, *supra* note 38, at 591-592 (“[P]rofessors Choi and Guzman provide the most comprehensive issuer choice based critique of the issuer nationality approach. They start by suggesting that I champion the issuer nationality approach over the issuer choice approach to avoid the ‘race to the bottom.’ I have in fact used this phrase, but primarily in connection with the consequences of globalization on U.S. disclosure standards under a transaction location approach”)(“With regard to issuer choice, however, the phrase does not accurately describe my concern...My concern is that, because each issuer’s private costs of disclosure exceed the social costs of its disclosure, while its private benefits are less than the social benefits, the resulting market failure will lead each issuer to choose a regime requiring it to disclose less than is socially optimal.”).

<sup>120</sup> Coffee, *supra* note 19, at 694. Professor Coffee argues the “Externality” effect.

<sup>121</sup> Coffee, *supra* note 47, at 1827-28. Professor Coffee provides his response to regulatory competition with three solid points.

<sup>122</sup> *Id.* at 1827.

are externally incomparable.<sup>123</sup> Therefore, establishing a common set of regulatory standard will facilitate investor comparison.<sup>124</sup>

As for enhancing economic situation, Professor Coffee suggests the laws of strong minority investor protection will increase financial development.<sup>125</sup> For example, adopting a prohibition against insider trading reduces capital cost.<sup>126</sup> Admittedly, according to regulatory competition, investors will discount the price they are willing to pay for securities if an issuer selects a regime which does not prohibit insider trading.<sup>127</sup> However, the externality effect remains.<sup>128</sup> In that market, the issuer who selects the regime that allows insider trading will affect the capital cost of other issuers who select the regime that prohibits insider trading,<sup>129</sup> because investors will assume they are vulnerable to the legal risk of insider trading in that market since they find insider trading is allowed in that market.<sup>130</sup>

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<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* at 1828.

<sup>126</sup> *Id.* Professor Coffee uses the current U.S. regulation prohibiting insider trading as an example.

<sup>127</sup> *Id.* (“...consider now the impact of the ‘issuer choice’ approach to securities regulation. If issuers could opt to be governed by a non-U.S. legal regime, even though they were listed on the NYSE, some might well opt for the law of a jurisdiction that does not prohibit insider trading. Proponents of ‘issuer choice’ will, of course, respond that an issuer that did so would be penalized by the market and would experience an appropriate discount in its share value.”).

<sup>128</sup> *Id.* (“But this does not respond to the more basic point that an externality has arisen: the immunity conferred on some firms to engage in insider trading may affect the cost of equity capital for all firms trading in that market. Rather than research the laws of numerous jurisdictions, investors may simply assume that they were vulnerable to insiders misappropriating material, nonpublic information and adjust prices downward in response.”)

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

Additionally, if we accept regulatory competition, it will result in the externality effect that the overall capital cost will rise.<sup>131</sup> Hence, it affects the reputational brand in the world of securities markets.<sup>132</sup> Professor Coffee believes that only the market with a brand name of a better quality of regulatory standard will develop into a major international market, and yet issuer choice contradicts the concept of a market building up a high standard reputation.<sup>133</sup>

Finally, Professor Coffee proposes two arguments stating that, in reality, it is difficult to reach the ideal of reducing the issuer's legal compliance cost via issuer choice of regulatory regime.<sup>134</sup> First, in the case of cross-listing, issuers select listing markets and regulatory regimes together so that the regulatory regime corresponds with the listing market,<sup>135</sup> because the motivation of cross-listing is to bond with regulation in the listing market to improve corporate governance as the bonding hypothesis suggests.<sup>136</sup> In addition, when domestic regulation is stricter than overseas regulation, the issuer cannot avoid the high cost of legal compliance by simply entering another market with lenient

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<sup>131</sup> *Id.* at 1829.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.* See also John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 *YALE L. J.* 1, 34-39 (2001).

<sup>134</sup> Professor Coffee suggests that in the case of cross-listing, it is difficult to reach the expectation of issuer choice. This dissertation believes it is the result of bonding to the foreign regulation. See Coffee, *supra* note 47, at 1762.

<sup>135</sup> *Id.* ("First, issuers choose a market and a regulatory regime together and cannot sever their choice of market from their choice of regulatory principles. Thus, it is impossible to enter a strong and deep market, while observing only the laws governing a thin or primitive market.").

<sup>136</sup> *Id.*

regulation in cross-listing, because the issuer still has to comply with the domestic regulatory standard.<sup>137</sup>

#### IV. Increasing Efficiency as the Regulatory Direction

Some scholars analyze the need for information disclosure from an economic perspective, suggesting that the proper regulatory direction is to match the efficiency of the U.S. economy,<sup>138</sup> because the people who primarily benefit from a country's issuer information disclosure are the country's entrepreneurial and labor forces rather than U.S. investors.<sup>139</sup> Therefore, the suggested regulatory approach should depend on "Issuer Nationality".<sup>140</sup> Specifically, the U.S. should impose its disclosure regime on all U.S. issuers that maintain the U.S. as their economic center of gravity.<sup>141</sup> The location of securities trading and the

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<sup>137</sup> *Id.* ("Second, the issuer cannot "exit" its home jurisdiction in a manner that truly escapes its potentially more stringent regulation."); *Id.* at n. 11 ("Increasingly in the global economy, it may be possible to make such an exit from the home country's laws...But that is not what is happening in the system of cross-listings that is currently emerging. Rather, the issuer would continue to disclose to its home country regulator according to its home country's rules and in addition disclose to the exchange on which it cross-lists according to that jurisdiction's rules.").

<sup>138</sup> See Fox, *supra* note 38; Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 Mich. L. Rev. 2498 (1997); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L.REV. 1335 (1999); Merritt B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQ. L. 563 (2001).

<sup>139</sup> Fox, *The Securities Globalization Disclosure Debate*, *id.* at 573, n.13. (Professor Fox explains: "If a country's issuers represent only a small portion of all equities available to investors in the world, investors would share in none of these gains. The country would be analogous to a single small firm in a perfectly competitive industry. Such a firm's level of production has no effect on price. Following this analogy, what the country produces is investment opportunities—dollars of future expected cash flow—just like the firm produces products. A disclosure improvement's positive effects on managerial motivation and choice of real investment projects will increase the number of dollars of future expected cash flow that the country has to sell. This benefits the entrepreneurs, who are selling the cash flow, and labor, who gain from the overall increase in the country's economic efficiency.").

<sup>140</sup> For the arguments of Professor Fox in his articles, see *supra* note 138.

<sup>141</sup> Fox, *supra* note 38, at 568.

residences of investors are not relevant.<sup>142</sup> As a result, the mandatory disclosure regime does not apply to those non-U.S. issuers even though those non-U.S. issuers offer their securities in the U.S. or list them on a U.S. exchange, and even if a significant number of investors trading their securities are U.S. residents.<sup>143</sup>

## **1. Mandatory Disclosure on the U.S. Issuer Benefits the Interest of the Entrepreneurs and Labor Associated with the U.S. Issuer Rather than Investors**

Mandatory disclosure on issuers benefits the issuer's business operation in several ways, and therefore contribute to overall social welfare.<sup>144</sup>

First, mandatory disclosure benefits the issuer in business competition. Professor Fox believes that there is a cost of information disclosure,<sup>145</sup> and that information disclosure is the "interfirm" cost of the production of business.<sup>146</sup> In other words, the cost arises when the disclosed item of information provided by an issuer puts the issuer in an unfavorable position relative to its competitors.<sup>147</sup> For example, the issuer's competitor will appreciate the information if they know

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<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at 569.

<sup>144</sup> Fox, *The Issuer Choice Debate*, *supra* note 138, at 569-73.

<sup>145</sup> Fox, *Id.* at 570.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*



that a particular line of the issuer's business is profitable.<sup>148</sup> Thus, the disclosure of such information becomes a cost to the issuer because the issuer's competitor may become better off in this business once the competitor knows about such information.<sup>149</sup> Such consequences will increase the cash flow of the competitor and yet drive down the cash flow of the issuer.<sup>150</sup> On the other hand, mandatory information disclosure imposed on both the issuer and its competitor leads to an equal basis that prevents one side from taking advantage of the other because both parties obtain information from each other.

Second, mandatory information disclosure on the part of issuers benefits issuers in increasing predictions about the future of the business course.<sup>151</sup> For instance, say there are two groups of information: the revelation of the first group will increase the issuer's cash flow, and the revelation of the second group will decrease the issuer's cash flow.<sup>152</sup> If there is no mandatory information disclosure on the issuer, the issuer will likely not disclose the second group of information.<sup>153</sup> Suppose the public accidentally found out an item of information in the group that the issuer had not disclosed: it will decrease the cash flow of the issuer.<sup>154</sup> Conversely, it will increase or leave unaffected the issuer's cash flow if the issuer

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<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 571.

<sup>152</sup> *Id.* Professor Fox takes the revelation of two groups of information as an example.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

chooses to reveal all the information because the disclosure enables the issuer and other companies in the market to accurately realize the potential business action and result with each other.<sup>155</sup> Consequently, it is beneficial to the overall market if companies know about the potential business action, thus making appropriate business response by the disclosure rather than the concealing of information.<sup>156</sup>

Finally, information disclosure improves corporate governance in several ways, such as assisting in the exercise of the shareholder franchise and in the shareholder enforcement of management's fiduciary duties.<sup>157</sup> It also reduces the risk of hostile takeover for potential acquirers because additional disclosure information is beneficial for accurately analyzing the price and relevant business factors of the target company.<sup>158</sup>

If there is no mandatory disclosure, the issuer may decide either to disclose or not to disclose.<sup>159</sup> Hence, competitors will take advantage of the issuer's disclosure, which increases the private cost of disclosure.<sup>160</sup> By contrast, mandatory disclosure imposes every issuer with the disclosure obligation. It turns

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<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> Fox, *supra* note 38, at 571.

<sup>158</sup> *Id.*

<sup>159</sup> *See id.* at 572; Fox, *The Issuer Choice Debate*, *supra* note 138, at 570.

<sup>160</sup> *Id.*

out the overall social cost of mandatory disclosure is less than the private cost of all issuers' voluntary disclosure.<sup>161</sup>

## **2. Interest of the Entrepreneurs and Labor Associated with the U.S. Issuer**

Mandatory information disclosure reduces the individual issuer's private business cost, which benefits the domestic entrepreneurs and labor associated with the issuer.<sup>162</sup> Professor Fox contends that investors of the issuers do not benefit from issuer's disclosure, and hence investor protection is not the focus of mandatory disclosure.<sup>163</sup> Professor Fox also argues that the cost of information disclosure does not reflect the actual value of securities under the efficient market hypothesis, even if the share price may be inaccurate: rather, it is the operation of the company that influences the securities value.<sup>164</sup> Facing an inaccurate price of

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<sup>161</sup> *Id.*

<sup>162</sup> Fox, *The Securities Globalization Disclosure Debate*, *id.* at 572-73.

<sup>163</sup> *Id.* at 573.

<sup>164</sup> *Id.* ("The reader may ask whether this analysis ignores another benefit of mandatory disclosure—investor protection—which will be concentrated where an issuer's investors are concentrated. The answer is no, because investor protection is not a sound justification for mandatory disclosure: disclosure is not necessary to protect investors against either unfair prices or risk. Consider first unfair prices. Under the efficient market hypothesis, securities prices are unbiased whether there is a great deal of information available about an issuer or very little. In other words, share prices will on average equal the actual value of the shares involved whether issuers are required to produce a lot of disclosure or only a little. Thus, greater disclosure is not necessary to protect investors from buying their shares at prices that are, on average, unfair, i.e., greater than their actual values."). However, information disclosure is believed to protect the investors' decision. Choi & Guzman, *supra* note 60 at 941-42. ("Underlying the notion of investor protection is the assumption that investors are unable to protect themselves. Investors may lack the resources to request information from issuers and analyze this information on their own. Investors may also act irrationally and make poor investment choices. Securities regulation, therefore, may play a role in forcing companies to provide information truthfully to investors."). In addition, if a company does not make information disclosure, investors will discount the price of the company to reflect the chance that the company does not accurately report its earnings. Demmo, *supra* note 16, at 710. Further, according to bonding hypothesis, investors prefer high level of disclosure because they believe the company is committed to enhance the quality of the corporate governance. See *supra* note 41, the arguments about bonding.

securities, investors can just diversify their investment portfolio to reduce potential risk.<sup>165</sup>

Overall, mandatory disclosure focuses on enhancing efficiency via better capital allocation and reduced agency costs of management.<sup>166</sup> Professor Fox believes that to accomplish maximum efficiency, the approach of mandatory disclosure on issuer nationality should be adopted because the country has a strong interest in the disclosure behavior of the domestic issuer who contributes to the benefit of the entrepreneurs and labor associated with the domestic issuer.<sup>167</sup> Countries do not have a strong interest in the disclosure behavior of foreign issuers even if domestic investors own those shares.<sup>168</sup> Whether a foreign issuer performs disclosure or not, domestic investors will receive the global expected rate of return on capital.<sup>169</sup> More disclosure by foreign issuers benefits domestic investors less than domestic investors doing more to diversify their investment portfolios.<sup>170</sup>

### **3. The Approach of Mandatory Disclosure on Issuer Nationality is Irreplaceable by Other Alternatives**

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<sup>165</sup> Fox, *The Securities Globalization Disclosure Debate*, *id.* at 573.

<sup>166</sup> See Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, *supra* note 138, at 2628.

<sup>167</sup> *Id.* at 2618.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

Scholars oppose letting issuers choose their preference of regulatory regime. Professor Fox believes that issuer choice will lead to the issuer selecting a regime requiring it to disclose at a less than socially optimal level, eventually resulting in market failure.<sup>171</sup> This is because the issuer's private cost of information disclosure is higher than the social cost of information disclosure.<sup>172</sup> For example, when the issuer's information disclosure of the items brings about positive effects on the cash flow to the issuer's competitors, the issuer will choose not to disclose all of these items. The additional disclosure benefits the issuer's competitors and reduces the issuer's cash flow, and thus it is a high cost to the issuer.<sup>173</sup> On the other hand, under mandatory disclosure, since every issuer is required to disclose information, each issuer benefits from the information disclosure of each other that increases the total social welfare.<sup>174</sup> Therefore, the overall social cost is relatively lower.<sup>175</sup>

Increasing economic efficiency is the main argument under the idea of mandatory disclosure on issuer nationality. In addition, issuer nationality is a simple regulatory standard to international securities regulation. Admittedly, the distinction between domestic and foreign issuers under issuer nationality may

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<sup>171</sup> Fox, *supra* note 38, at 591.

<sup>172</sup> Fox, *The Issuer Choice Debate*, *supra* note 138, at 573.

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

lead to unequal treatment.<sup>176</sup> However, since countries have strong interests regarding the disclosure of the domestic issuer who contributes to the benefits of the entrepreneurs and labor associated with the domestic issuer, it is neither necessary nor important to require the foreign issuer with the disclosure obligation.<sup>177</sup>

Furthermore, as investor protection is not the primary concern according to economic analysis, there is no need to impose information disclosure on the foreign issuer from the investor protection perspective. Professor Fox indicates that issuers are sensitive to the level of the current U.S. regulatory structure by distinguishing if the securities trading is in the U.S. or not.<sup>178</sup> Such approach from the view of domestic investor protection tends to cause the regulator to decrease the regulatory standard on the foreign issuer under political pressure.<sup>179</sup> The mandatory disclosure on issuer nationality can correct this inadequacy.<sup>180</sup>

On top of that, issuer nationality is able to achieve the bonding effect as the bonding hypothesis suggests because issuer nationality does not forbid non-domestic issuers from applying the domestic regulatory standard.<sup>181</sup> In other

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<sup>176</sup> Professor Fox provides his response to the critiques from transaction location and investor residency. *See* Fox, *supra* note 38, at 577-79.

<sup>177</sup> *Id.*

<sup>178</sup> Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, *supra* note 138, at 2621-22.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> Fox, *supra* note 38, at 586.

words, foreign issuers are still allowed to choose the same disclosure standard as the one domestic issuers comply with, although what mandatory disclosure cares about the most is the influence on the welfare of U.S. residents.<sup>182</sup>

Last, regulatory harmonization is not feasible from an economic analysis standpoint,<sup>183</sup> because every nation has a different standard of its social welfare level, making it difficult to reconcile the diversity of each nation's interest of the entrepreneurs and labor.<sup>184</sup> Imposing regulatory harmonization will lead to the sacrifice of any nation's interest due to the unnecessary social cost of disclosure or an otherwise insufficient level of disclosure.<sup>185</sup> Certainly, one may argue the example of the European Union is a successful case regarding regulatory harmonization. However, the European Union has undergone an evolution of political and economic unity for many decades. Obstacles exist in the process of unity, and reconciliation is complicated.

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<sup>182</sup> *Id.*

<sup>183</sup> *Id.* at 593-95.

<sup>184</sup> *Id.* at 594.

<sup>185</sup> *Id.* at 595.

## **Chapter 3: Regulatory Structure Regarding Securities Issuance in the U.S.**

### **I. Overview**

Despite theoretical proposals from diversified perspectives, current U.S. law chooses the traditional route of taking investor protection as the regulatory direction. The regulator believes securities information must be disclosed in order to prevent investors from making ill-informed decisions before engaging in securities transactions.<sup>186</sup> Hence, the issuer's most important obligation is the information disclosure obligation. The regulatory structure regarding the issuer's obligation is founded on and developed from the information disclosure obligation. Then there are relevant obligations that reinforce the regulatory structure of the information disclosure requirement, including the check and balance mechanism of corporate governance member installment and internal control requirements as well as the quantitative requirements of listing standards in securities exchanges.

The process of internationalization accelerates the participation of foreign issuers in the U.S. market. The U.S. market has become the world financial center because the U.S. regulatory system has facilitated the operational efficiency of the U.S. securities market and international capital mobility via adopting specific regulatory approaches for foreign issuers. By researching these regulatory

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<sup>186</sup> See *supra* note 12.



approaches, we can better understand how the current regulatory direction corresponds with the merits in theoretical analysis, which is the basis for the future regulatory reformation.

## **II. Regulatory Requirements for Securities Issuers**

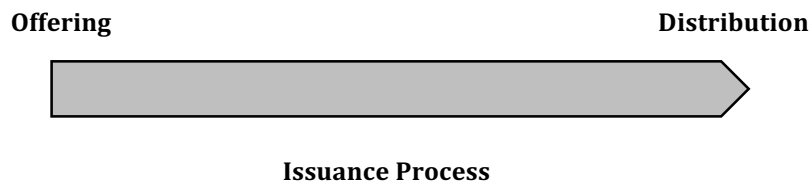
### **1. Information Disclosure Obligations**

As stated previously, the information disclosure is the issuer's most important obligation. Since there is a severe information asymmetry existing in the exchange market, the issuer is required to disclose material information to investors.

#### **(1) Information Disclosure Obligations Regarding Securities Issuance**

The obligation of information disclosure affects not only the issuer, but also the underwriter who is responsible for the securities distribution for the issuer. In the process of securities issuance, the issuer will have to conduct an offer or a sale to the securities purchaser. However, the issuance is not complete until the underwriter distributes the securities in the issuing market. The securities issuance process consists of the first step of offering and the later step of distribution. See Chart 2 for reference.

## Chart 2: Securities Issuance Process



Source: The Author.

From the issuer's perspective, the underwriter who helps the issuer finish the issuance process is acting like an agent of the issuer. The persons who are involved in the issuance are expected to comply with the information disclosure obligation.<sup>187</sup> Securities that are not fully disclosed are called "restricted securities". After the securities are issued in the issuing market, the information is fully disclosed and thus the securities can be freely transacted in the trading market. Thus, restricted securities become non-restricted, and dealers who trade non-restricted securities in the trading market are not responsible for the information disclosure obligation.

Investors can obtain the disclosure of information through the issuer's securities registration and reporting. The registration obligation is a one-time immediate disclosure about the information of the issuer and the description of the securities to be issued, whereas the report obligation is a periodical or non-

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<sup>187</sup> The underwriter must comply with the information disclosure obligation. See J. William Hicks, *The Concept of Transaction as a Restraint on Resale Limitations*, 49 OHIO. ST. L.J., 425-26 (1988).

periodical continuous ongoing disclosure regarding the substantial information of the issuer.

Under the U.S. framework, securities registration can be further divided into 1) registration for securities offering and sale pursuant to the Securities Act of 1933 (“Securities Act”) and 2) registration for listing and trading on a securities exchange pursuant to the Securities Exchange Act of 1934 (“Exchange Act”). The securities registration under the Exchange Act is a different obligation from the registration under the Securities Act. The Exchange Act requires registration for the benefits of the investors who purchase securities in the public trading market of a securities exchange.<sup>188</sup>

## **A. Immediate Information Disclosure — Registration Obligations**

### **(A) Registration for Securities Offering and Sale**

The purpose of registration under the Securities Act is to ensure that the issuer provides investors with complete information disclosure about the securities that the issuer is offering.<sup>189</sup> Conceptually, registration under the

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<sup>188</sup> See BRADLEY BERMAN & ZE'EV D EIGER, MORRISON & FOERSTER LLP, CONSIDERATION FOR FOREIGN BANKS FINANCING IN THE UNITED STATES: 2014 UPDATE 9 (2014), <http://www.iflr.com/pdfs/IFLR-Considerations-for-Foreign-Banks-Financing-in-the-US-2014-Update.pdf> (last visited Oct. 17, 2016).

<sup>189</sup> *Id.*

Securities Act emphasizes the information disclosure in the “Issuing Market”.<sup>190</sup> Section 5 of the Securities Act elaborates on the securities registration and prospectus delivery requirements for securities offerings.<sup>191</sup> There are two kinds of registrations, including conventional offerings registration and shelf registration.<sup>192</sup> Under certain circumstances, shelf registration provides greater flexibility, allowing registration of securities in advance for securities expected to sell within a two-year period.<sup>193</sup> Section 10 of the Securities Act requires a prospectus meeting to be completed and delivered prior to sale.<sup>194</sup> According to Section 5, registration and prospectus delivery requirements require filing with the SEC.<sup>195</sup> The SEC then will review the document and provide the issuer with comments. Once the SEC staff is satisfied with the registration statement, the issuer may use their registration statement in their securities offering.<sup>196</sup> Depending on the nature of the issuer, there is a variety of registration statements available.<sup>197</sup>

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<sup>190</sup> The “Issuing Market” (or “Primary Securities Market”) refers to the issuing market where the capital demander, including the government, financial centers, and enterprises, sells securities to the original purchaser. The “Trading Market” (or “Secondary Securities Market”) is the market for securities transaction after securities issuance. The function of the Issuing Market is to facilitate fundraising of the capital for the issuers, whereas the function of the Trading Market is to let the initial securities investors selling their securities for cash or other purposes. *See*, STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASE AND MATERIAL 9-16 (3<sup>rd</sup> ED 2012).

<sup>191</sup> Securities Act Section 5; 15 U.S.C. § 77e (2012).

<sup>192</sup> *See* HAL S. SCOTT ET AL. *supra* note 59, at 24.

<sup>193</sup> *Id.*

<sup>194</sup> Securities Act Section 10; 15 U.S.C. § 77j (1954).

<sup>195</sup> Securities Act Section 5; 15 U.S.C. § 77e (2012).

<sup>196</sup> *Supra* note 188.

<sup>197</sup> E.g. Form F-1, F-2 and F-6. *See id.*

## (B) Registration for Securities Listing and Trading

After an issuer has registered the securities pursuant to the Securities Act for the securities offering and sale, the issuer may have its securities listed and traded on a securities exchange. This way, the issuer has to register its securities under the Exchange Act. The registration under the Exchange Act is an independent obligation regardless of whether the securities previously have been registered under the Securities Act.<sup>198</sup>

The purpose of registration under the Exchange Act is to ensure that investors obtain enough information in the trading market of a securities exchange.<sup>199</sup> However, registration is not only required when the securities are actually listed; it is also required in cases where the scale of the issuer reaches a certain size, because the information interest of a large number of investors on securities trading is influenced. Hence, two situations trigger the registration under the Exchange Act.

The first situation is when a class of the issuer's securities is listed on a national securities exchange, which means that the issuer has to register its securities pursuant to Section 12(b) of the Exchange Act.<sup>200</sup> The second situation is when the scale of the issuer reaches a certain size that **means** the issuer's

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<sup>198</sup> *Supra* note 188.

<sup>199</sup> *Id.*

<sup>200</sup> Exchange Act Section 12(b); 15 U.S.C. § 78l (a) (2015).

securities are held by a large number of investors. Since a big size issuer influences the information interest of a large number of investors on securities trading, securities registration is required pursuant to Section 12(g) of Exchange Act.<sup>201</sup>

## **B. Ongoing Information Disclosure—Reporting Obligation**

A “reporting company” has the obligation to provide investors with an ongoing disclosure of material information about the company. Both the registrations under the Securities Act and the Exchange Act enable the issuer to become a reporting company that has to fulfill the ongoing disclosure requirements subject to the Exchange Act. Three situations trigger reporting: first, when an issuer lists a class of the issuer’s securities on a national securities exchange;<sup>202</sup> second, when the scale of the issuer reaches a certain size which influences the information interest of a large number of investors on securities trading;<sup>203</sup> and last, when an issuer conducting a public offering files a registration statement under the Securities Act.<sup>204</sup>

The Exchange Act reporting requirements emphasize on the periodic information disclosure obligation. The issuer also has to comply with a non-periodic material information disclosure obligation under Regulation FD.<sup>205</sup> The

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<sup>201</sup> Exchange Act Section 12(g). 15 U.S.C. § 78l (g)(2015).

<sup>202</sup> Exchange Act Section 12(b); 15 U.S.C. § 78l (b)(2015).

<sup>203</sup> Exchange Act Section 12(g); 15 U.S.C. § 78l (g)(2015).

<sup>204</sup> Exchange Act Section 15(d); 15 U.S.C. § 78o (d)(2015).

<sup>205</sup> Regulation FD; 17 C.F.R. Part 243 (2000).

purpose of reporting, which is an ongoing obligation rather than a one-time obligation, is to let potential investors know about the information in the trading market because the securities will be traded repeatedly after the issuance.<sup>206</sup> The ongoing information disclosure is necessary because the operation and the financial status of the issuer fluctuates after the issuance of securities.

## **(2) Exemptions from Information Disclosure Obligations**

Securities registration, by way of immediate information disclosure, fills the gap of information asymmetry between the issuer and investors. Regarding registrations, U.S. law imposes two registration obligations respectively, on the issuance of securities as well as on the listing on the trading market of a securities exchange. However, U.S. law exempts the issuer from the registration obligation under certain situations. Securities registration exemptions include the offering and sale exemption as well as the listing and trading exemption.

### **A. Offering and Sale Exemption**

The law allows for “exempted transactions” and “exempted securities”. In exempted transactions, U.S. law exempts transactions from registration under the premise that the issuer does not influence the interests of investors in the public.

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<sup>206</sup> See Anna T. Pinedo et al, Morrison & Foerster LLP, *Frequently Asked Questions about Periodic Reporting Requirements for US Issuers Overview*, <https://media2.mofo.com/documents/faq-periodic-reporting-requirements-for-us-issuers-overview.pdf>. (last visited Sep. 15, 2016).

In exempted securities, certain kinds of securities issued by the government or banks are exempt from registration under the Securities Act because these securities are issued by the entities highly regulated. These entities will disclose enough information about their business and operations to investors in the absence of the securities registration requirement pursuant to the Securities Act.<sup>207</sup> The difference between the situation of exempted transactions and exempted securities is that exempted transactions allow the issuer to exempt from registration only on the transaction that fulfills statutory or regulatory requirements, whereas exempted securities provide exemption at every transaction if the issuer belongs to the entity under statutory provisions.

### **(A) Exempted Transactions**

In the issuance of securities, information asymmetry exists between the issuer and investors. Hence, information disclosure is required for the issuer conducting securities offering and sale in the issuing market. Before an issuer fully discloses the information about the securities to the public, the securities are called “restricted securities”.<sup>208</sup> Restricted securities are unable to be freely traded. Until the issuer discloses material information, restricted securities become “non-restricted securities” and thus can be traded freely in the “trading market”.

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<sup>207</sup> *Supra* note 188, at 19.

<sup>208</sup> “Restricted” Securities: Removing the Restrictive Legend, U.S. Securities and Exchange Commission, <https://www.sec.gov/answers/restric.htm> (last visited Sep. 15, 2016).



Certain transactions merit exemption from registration. The first situation arises when sophisticated investors who can protect themselves purchase the securities, in which case the issuer can transfer restricted securities to the purchaser without registration; the other situation arises when the issuer sells the securities to a trading market outside the domestic jurisdiction, which will not endanger the interests of domestic investors. The exemption of securities registration facilitates efficient and effective fundraising. The common characteristic of these transactions is the non-influenced interests of investors in the public, and thus the information disclosure to the public is not required.

In transactions wherein the securities registration is exempt from registration, the law creates special channels of markets that allow restricted securities to be sold and traded under certain conditions. The regulator will deem the information disclosed between the issuer and the purchaser in the transaction of these channels. However, the nature of the securities remains restricted because the issuer does not provide ongoing information to the public. In order to protect the interests of other investors in the public market, restricted securities cannot be traded freely out of the special channels of these markets.

Two situations enable restricted securities to become unrestricted securities, which can be traded in the public afterwards.<sup>209</sup> In one situation, U.S.

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<sup>209</sup> Certain requirements bring about accessibility of information to investors, enabling restricted securities become unrestricted securities. These requirements appearing in SEC rules are discussed in the following paragraphs.

law requires the issuer to provide ongoing information to the public, which lets the potential investors in the public market eventually know about material information. In the other situation, the initial purchaser has to wait for a certain securities holding period before selling the securities to the public. The law believes that the passing of the holding period justifies the lack of information disclosure.

There are three broad categories of the issuer's exemption from registration depending on the subject of the transaction. The first category is issuer exemption; namely, the exemption applies to situations in which the issuer conducts securities offering.<sup>210</sup> The second category is the resale exemption, which states that restricted securities that cannot be resold without the issuer's registration may be traded by the reseller with exemption from registration if the resale of the transaction fulfills specific conditions.<sup>211</sup> The third category is the exemption available on the transactions of both the issuer and the resale.

### **a. Issuer Exemption — Private Placement**

Section 4(a)(2) of the Securities Act outlines an exemption from registration in situations in which issuers sell securities limited numbers of sophisticated investors, resulting in so-called "private placements" rather than placements with

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<sup>210</sup> See Jeffery Bell, Morrison & Foerster LLP, *U.S. Securities Offerings and Exchange Listing by Foreign Private Issuers*, <https://media2.mofo.com/documents/fpi-memo.pdf>. (last visited Sep. 15, 2016)

<sup>211</sup> *Id.* at 3.

the general public.<sup>212</sup> The rationale of this exemption is that the regulation applicable to public offerings is not required when an issuer makes offerings to a limited number of offerees who can protect themselves.<sup>213</sup> Private placements are useful and attractive because they enable the issuer to raise large amounts of capital without the cost and delays of registration.<sup>214</sup> To make fundraising even more efficient, the issuer may use private placements combined with other regulatory mechanisms such as Rule 144A and Regulation S to accelerate the process.

Whether or not an issuance of securities is involved in any public offering is up for interpretation. Regulation D provides safe harbor, stating under what circumstances the sales are considered as private placements, and thus are exempted from registration.<sup>215</sup> Generally speaking, the purchasers of private placements have to be sophisticated and powerful enough to protect themselves, or capable of obtaining information for themselves so the issuer does not have the obligation to make securities registration. However, the issuer has to provide information to the purchaser if the purchaser asks them to do so.<sup>216</sup> To ensure the

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<sup>212</sup> Securities Act Section 4 (a)(2); 15 U.S.C §77d(a)(2)(2015).

<sup>213</sup> *Supra* note 188, at 14.

<sup>214</sup> *Id.* at 28.

<sup>215</sup> Regulation D; 17 C.F.R. 230.501-506 (2013).

<sup>216</sup> *See supra* note 188, at 28. (“The nature and kind of information provided to offerees or to which offerees have ready access: The disclosure need not be as extensive as that in a registered offering, but must be factually equivalent. Disclosing basic information regarding the issuer’s financial condition, business, results of operations, and management is satisfactory. All information must be made available prior to sale.”); *See also* SEC Release No. 33-3825 (August 12, 1957); SEC Release No. 33-4552 (November 6, 1962); and SEC Release No. 33-5121 (December 30, 1970).

purchaser's protection in private placements, there are some requirements. For example, the issuer should grant the purchaser effective access to information.<sup>217</sup> Additionally, the quantity of purchasers is limited. In principle, the regulator prohibits general advertising or general solicitation to ensure the protection of other investors in the public by preventing their involvement in the transaction.<sup>218</sup> Regulation D permits the issuer conducting private placements to only 35 "non-accredited investors".<sup>219</sup> Also, private placements to an unlimited number of "accredited investors" via general solicitation or advertising are acceptable if the issuer takes "reasonable steps to verify" that the purchasers are accredited investors.<sup>220</sup> Accredited investors include (1) financial institutes such as banks, brokers and insurance companies, (2) affiliates such as directors or executive officers of the issuers, and (3) wealthy individuals.<sup>221</sup>

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<sup>217</sup> *Id.*

<sup>218</sup> Rule 502(c) of Regulation D; 17 C.F.R. 230.502(c)(2013).

<sup>219</sup> Rule 506(b) of Regulation D; 17 C.F.R. 230.506(b)(2013). Fast Answers, SEC Rule 506 of Regulation D, U.S. Securities and Exchange Commission, <https://www.sec.gov/answers/rule506.htm>. (last visited Sep. 15, 2016). ("Under Rule 506(b), a company can be assured it is within the Section 4(a)(2) exemption by satisfying the following standards: The company cannot use general solicitation or advertising to market the securities; The company may sell its securities to an unlimited number of "accredited investors" and up to 35 other purchases.").

<sup>220</sup> Rule 506(c) of Regulation D; 17 C.F.R. 230.506(c)(2013). Fast Answers, SEC Rule 506 of Regulation D, U.S. Securities and Exchange Commission, <https://www.sec.gov/answers/rule506.htm>. (last visited Sep. 15, 2016). ("Under Rule 506(c), a company can broadly solicit and generally advertise the offering, but still be deemed to be undertaking a private offering within Section 4(a)(2) if: The investors in the offering are all accredited investors; and The company has taken reasonable steps to verify that its investors are accredited investors, which could include reviewing documentation, such as W-2s, tax returns, bank and brokerage statements, credit reports and the like").

<sup>221</sup> SEC Rule 501(a) of Regulation D, 17 C.F.R. 230.501(a)(2013).

Private placements for foreign issuers are almost always a matter of debt securities, because most foreign issuers want to avoid having too many U.S. holders of equity securities if those foreign issuers wish to avoid U.S. reporting requirements.<sup>222</sup> Section 12(g) of the Exchange Act makes the issuer with a certain number of investors holding its equity securities become a reporting company even if the issuer does not actually list its securities on national securities exchanges.<sup>223</sup>

### **b. Resale Exemption**

While the issuer exemption initiates a special kind of channel, allowing the issuer to transfer restricted securities in an efficient way, the resale exemption maintains the continuous transfer of restricted securities in the special channels of trading markets. The resale exemption maintains great liquidity, to the advantage of the issuer. However, since the issuer does not fulfill securities registration requirements, the securities remain restricted. Restricted securities can only transfer in these channels under statutory or regulatory requirements, rather than being traded out to the public. Only when certain conditions are fulfilled—i.e., a certain amount of time has passed, or the issuer discloses ongoing information to the public—do restricted securities become unrestricted securities,

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<sup>222</sup> See BERMAN & EIGER, *supra* note 188, at 14.

<sup>223</sup> *Id.*

and thus can be transferred out of that special channel and to be freely traded in the public.<sup>224</sup>

In addition, resale exemption provides instructions to prevent certain securities resale from being considered as securities distribution. The issuer who conducts securities issuance has to register its securities with the SEC to disclose relevant material information because there is an asymmetry of information existing between the issuer and investors in the public market. Investors who acquire the securities and later resell them in the securities market do not have to perform the registration obligation because ordinary investors are not responsible for the information disclosure obligation.<sup>225</sup> The goal of investors is to obtain the profit from the investment by the resale of the securities. However, some people purchase the securities from the issuer in order to engage in distribution of the securities rather than investment. These people are called “underwriters”. The underwriter who purchases restricted securities from the issuer and then resells those restricted securities has the duty to register those securities because the underwriter acts as the issuer’s agent, which means they are very close to the issuer, and they are responsible for performing the duty of material information disclosure about the situation of the issuer.<sup>226</sup> Chart 3

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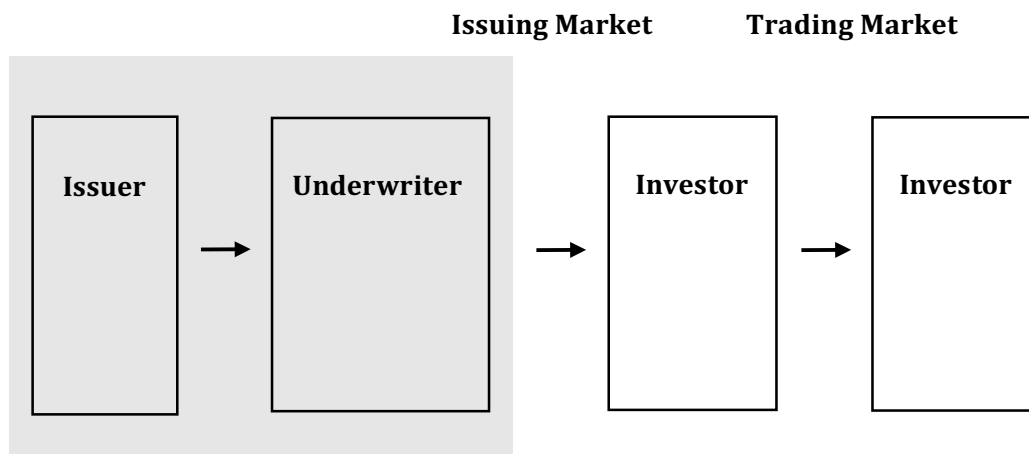
<sup>224</sup> This dissertation discusses how the lapse of time justifies the way of information disclosure as the holding period of restricted securities, and how it is always a necessary requirement before the resale of restricted securities to the public. Theoretically, there is another implied requirement that the issuer would continuously disclose information so that the material information, which is revealed as time goes by.

<sup>225</sup> Securities Act Section 4 (a)(1); 15 U.S.C. § 77d(a)(1) (2015).

<sup>226</sup> *Id.*

indicates that the grey area is the issuance process. The underwriter is responsible for registration because the issuance process is not finished.

**Chart 3: The Underwriter Is Responsible for Registration**



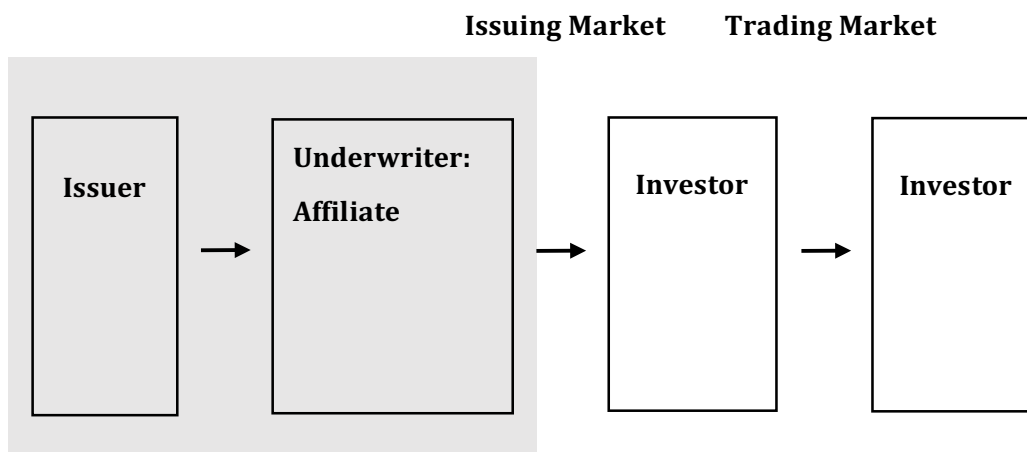
Source: The Author.

When the issuer’s affiliates—such as directors and managers who have controlling power and substantial influence in the company—purchase restricted securities from the issuer and then resell those restricted securities, the affiliates are also required to fulfill the obligation of securities registration with the SEC.<sup>227</sup> These controlling affiliates have to register the securities because these people

<sup>227</sup> Securities Act Section 2 (11); 15 U.S.C. § 77b(a)(11) (2015) (“The term “underwriter” means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors’ or sellers’ commission. As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.”[emphasis X]).

with controlling power possess knowledge about material information of the company. Therefore, the resale of securities by the controlling affiliates to the public is like the way they are distributing securities for the issuer. Hence, we treat the resale by affiliates the same way we treat underwriters engaging in a securities distribution.<sup>228</sup> See Chart 4 for reference. The moment the underwriter finishes distributing the securities, rather than the moment the issuer sells the securities to the underwriter, completes the securities issuance to the public.<sup>229</sup>

**Chart 4: The Affiliate Who Acquires the Status of Underwriter Is Responsible for Registration**



Source: The Author

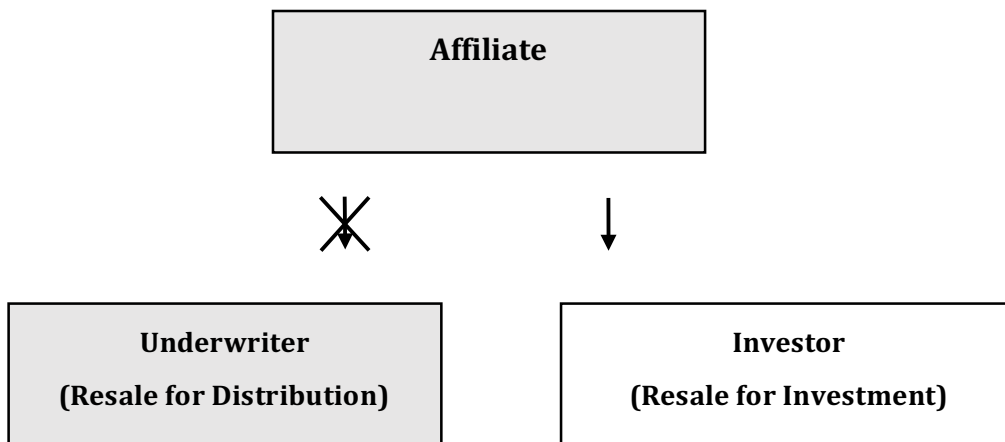
<sup>228</sup> In fact, the point is to examine whether the controlling person has achieved the legal status of the underwriter who conducts the resale of securities with a view to a distribution. If the controlling person has achieved the status as the underwriter, the controlling person is responsible for information disclosure obligation. Similar opinion *see* Chuang, *supra* note 11, at 17-20.

<sup>229</sup> In this situation, the securities issuance process is not yet complete. The issuance process is not complete until the underwriter carries out the distribution procedure. The securities go into the trading market after the distribution.



The approach of requiring the controlling affiliates to fulfill the information disclosure obligation is beneficial for the protection of investors in the securities market. However, it is very inconvenient for the affiliates who do not intend to engage in a distribution but plan to conduct investment. We are likely to deem such affiliates as underwriters in the transactions; thus, they have to fulfill the registration obligation.<sup>230</sup> As a result, in order to facilitate the capability of fundraising, the SEC has adopted several rules as safe harbors to the affiliate who is typically considered an underwriter. See Chart 5.

**Chart 5: How to Recognize an Affiliate as an Investor Rather than an Underwriter**

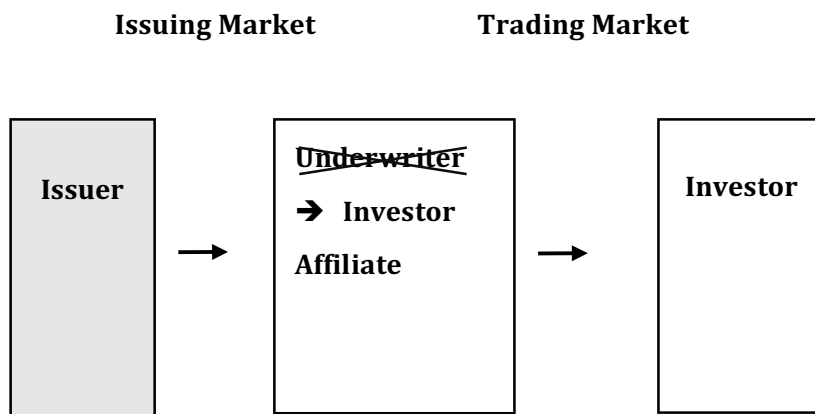


Source: The Author

<sup>230</sup> In the past, some securities holders who have the tendency of underwriting (but do not intend to engage in distribution, but do plan to conduct investment) were deemed as the underwriter, and thus were required to be responsible for information disclosure. See *SEC v. Chinese Consolidated Benevolent Association, Inc.*, 120 F.2d 738 (2<sup>nd</sup> Cir. 1941).

The idea of the safe harbors is to provide guidelines, based on which we can attribute the reseller with certain characteristics to an investor rather than an underwriter. Therefore, the reseller who would originally be considered as an underwriter will be deemed as an investor. See Chart 6 for reference.

**Chart 6: How an Affiliate can be Considered as an Investor**



Source: The Author

### **(a) Resale to the Public — Rule 144**

Rule 144 covers the rule of securities registration exemption for resale to the public. The reseller who fulfills the requirements under Rule 144 will no

longer be considered an underwriter.<sup>231</sup> Rule 144 can be divided into “restricted securities” and “non-restricted securities”.<sup>232</sup>

Restricted securities are securities that are not issued by the process of public offering. In order to avoid the tedious process of registration, the foreign issuer tends to conduct private placement by the issuance of restricted securities. The securities remain restricted until they meet requirements under Rule 144. The reseller can also fall into one of two categories, the affiliate holder and the non-affiliate holder.<sup>233</sup> For the non-affiliate holder of restricted securities, the holder may resell the securities without limitation after six months if the issuer is a reporting company, or after one year in the case of a non-reporting company.<sup>234</sup> The affiliate holder is subject to the same six-month and one-year holding periods, but additionally, they are subject to other resale conditions, including public information about the issuer and notice filings to the SEC, the volume limitation, and the manner of sale.<sup>235</sup> In short, it is a rule of “transforming” restricted

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<sup>231</sup> Rule 144. 17 C.F.R. § 230.144 (2012) (“Persons deemed not to be engaged in a distribution and therefore not underwriters”). Rule 144 is the so-called “dribble out” rule which refers to when the securities reseller conducting securities resale with appropriate volume of securities on each transaction. *See* THOMAS LEE HAZEN, *PRINCIPLE OF SECURITIES REGULATION*, 125 (2<sup>ND</sup> ED. 2006). The regulators believe that the reseller will look more like a regulator investor rather than an underwriter with a small volume of securities resale. In other words, the low volume of securities resale justifies the way that the resale by the affiliate holder is an ordinary investment rather than distribution; *See* JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIAL* 482 (3<sup>RD</sup> ED. 2001). (“...a person reselling securities under Section 4(1) of the Act must sell the securities in such limited quantities and in such a manner so as not to disrupt the trading markets. The larger the amount of securities involved, the more likely it is that such resales may involve methods of offering and amounts of compensation usually associated with a distribution rather than routine trading transactions.”).

<sup>232</sup> 17 C.F.R. § 230.144(a)(3) (2012).

<sup>233</sup> 17 C.F.R. § 230.144(a)(1) & (b)(1) (2012).

<sup>234</sup> 17 C.F.R. § 230.144(d)(1) (2012).

<sup>235</sup> 17 C.F.R. § 230.144(c) (2012); 17 C.F.R. § 230.144(e) (2012); 17 C.F.R. § 230.144(f) (2012).

securities into non-restricted securities under certain circumstances. After transactions fulfill the requirements, restricted securities are no longer restricted, meaning that the securities can be freely resold to the public trading market.

U.S. law imposes requirements on the affiliate holder and the non-affiliate holder respectively. In brief, the affiliate holder mainly has to fulfill volume limitation and its relevant restrictions, such as the resale manner and the holding period. The affiliate holder faces stricter requirements because the regulator is afraid that the issuer will avoid the registration obligation by the assistance of the affiliate holder conducting securities resale.

The rationale of volume limitation and its relevant restrictions holds that the sale of a small amount at once tends to be like investment rather than distribution. Additionally, the rationale of the holding period maintains that the affiliate holder is more like an investor rather an underwriter if the securities holder has established a sufficiently long holding period.<sup>236</sup> The issuer is also able to disclose material information during the holding period, which provides a justified reason to “transform” restricted securities into non-restricted securities after a certain period of time.

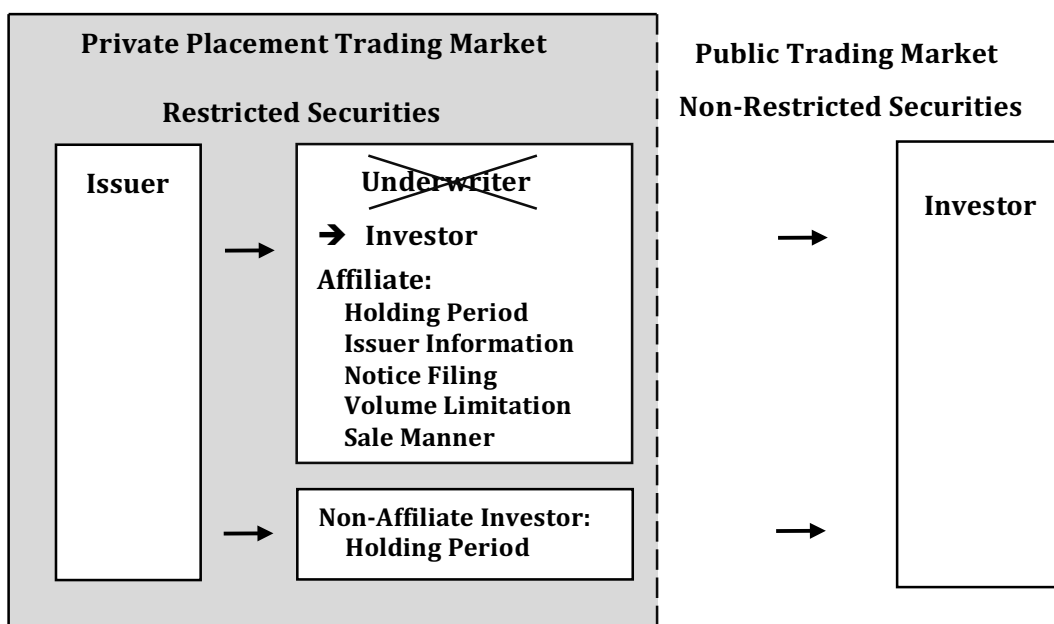
On the other hand, the non-affiliate holder only has to follow the requirement of the holding period, for the same reason that we let the issuer to disclose material information during the holding period. There is no volume restriction

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<sup>236</sup> “If the securities holder has established a sufficiently long holding period, this should demonstrate that the holder is more like an investor rather an underwriter.” JOHN C. COFFEE JR. ET AL. SECURITIES REGULATION: CASES AND MATERIALS, 548-50 (13<sup>TH</sup> ED. 2015).

because there is no concern that the non-affiliate holder will conduct distribution. See Chart 7 for the illustration of Rule 144 works for the resale of restricted securities.

**Chart 7: The Way How Rule 144 Works for the Resale of Restricted Securities**



Source: Compiled by the Author.

Regarding non-restricted securities, there is less restriction on the reseller because the issuer has disclosed information to the public via the process of securities offering. The affiliate holder reselling non-restricted securities must follow the same conditions as those of the resale of restricted securities except for

the requirement of the holding period.<sup>237</sup> As for the non-affiliate holder, there is no condition for reselling.

There is no way the affiliate holder can conduct distribution in the case of reselling non-restricted securities because the issuer has already fulfilled the information disclosure obligation. However, the affiliate holder still must meet the resale requirements of volume limitation and its relevant restrictions even with the resale of non-restricted securities, because the regulator is concerned that the

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<sup>237</sup> 17 C.F.R. § 230.144(c) (2012); 17 C.F.R. § 230.144(e) (2012); 17 C.F.R. § 230.144(f) (2012). There is a volume limitation on transferring non-restricted securities on affiliates because affiliates may lead to a disruption on the market with its information advantage. However, since the securities issuance process is complete, the issuer has disclosed material information. Thus, there is no way of conducting securities distribution anymore. Affiliates transferring non-restricted securities should not be treated as the way the underwriter distributing restricted securities. *See* Chuang, *supra* note 11 at 24-25. *See also*, STEPHEN J. CHOI & A.C. PRITCHARD, *supra* note 190, at 639. (“Why limit the volume of sales by affiliates? Consider the following excerpt from the SEC release promulgating Rule 144:

It is consistent with the rationale of the Act that Section 4(1) be interpreted to permit only routine trading transactions as distinguished from distributions. Therefore, a person reselling securities under Section 4(1) of the Act must sell the securities in such limited quantities and in such a manner so as not to disrupt the trading markets. The larger the amount of securities involved, the more likely it is that such resales may involve methods of offering and amounts of compensation usually associated with a distribution rather than routine trading transactions. Thus, solicitation of buy orders or the payment of extra compensation are not permitted by the rule.

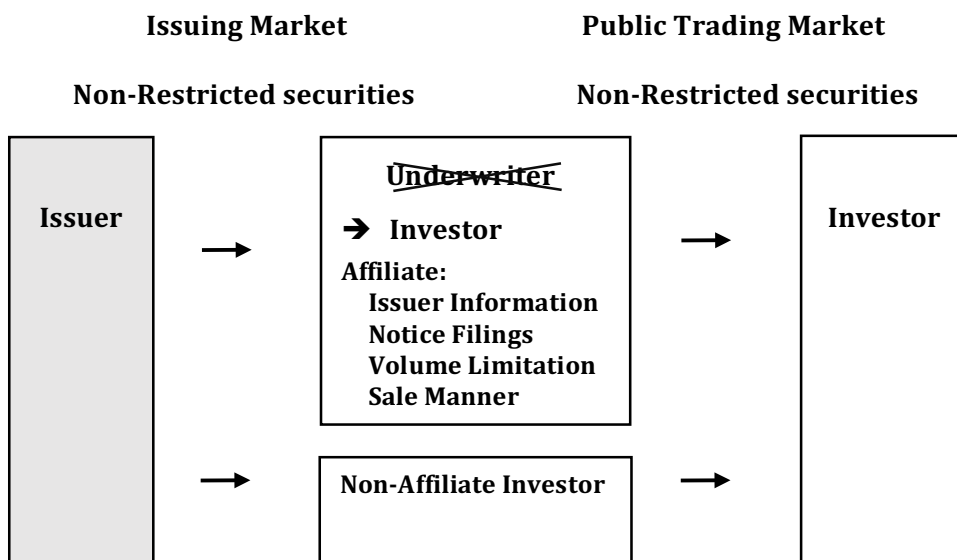
Securities Act Release No. 33-5223 (Jan. 11, 1972).

The SEC’s first justification for the volume limit in Rule 144 is a fear that a large number of securities entering the market at once will disrupt the market. A large sale of securities may cause the stock price, at least temporarily, to drop. Rule 144’s volume limitation may help avoid such a shock to the market. This rationale is not without problems. Large block sales of previously registered securities are not restricted by Rule 144. Non-affiliates may sell an unlimited amount of securities into the public securities markets. Moreover, the risk of a large stock price drop from a large block sale is unclear. Sellers have a natural incentive not to cause the stock price to drop precipitously as they sell their shares because it will reduce the proceeds from their sales. They will therefore try to disguise their sales by breaking them up among a number of brokers or spacing them out over time.

The second rationale is that the sale of a large amount of securities at once increases the likelihood that the reselling investors may use tactics associated with public offerings – inducing offering brokers greater commissions and attempting to condition the market with overly positive information on the company. Limiting the size of an offering may therefore indirectly limit the incentive to use public offering tactics.”).

resale of the affiliate holder will disrupt the market if the affiliate holder is reselling a large amount of securities at once.<sup>238</sup> However, from the perspective of information disclosure, the restriction on the affiliate holder is questionable.<sup>239</sup> View Chart 8 for an illustration of how Rule 144 works for the resale of non-restricted securities.

**Chart 8: How Rule 144 Works for the Resale of Non-Restricted Securities**



Source: Compiled by the Author.

**(b) Private Resale — Section 4 (a)(1 1/2) Exemption**

<sup>238</sup> See CHOI & PRITCHARD, *id.*

<sup>239</sup> *id.*

When the issuer sells restricted securities by private placement, the affiliate and the non-affiliate holders cannot resell the securities unless they comply with the holding period and other relevant conditions of Rule 144. If the securities holder plans to resell the restricted by private placement, the securities registration is not exempted because the reseller is not the issuer to whom the exemption requirement pursuant to Section 4(2) of private placement applies. In addition, the law will not consider the reseller to be a securities investor if the reseller does not fulfill the conditions under Rule 144. However, common law creates an exemption for the purchaser of restricted securities conducting private resale to the subsequent purchaser even if the initial purchaser does not fulfill the requirements of Rule 144. Hence, the initial purchaser is allowed to resell restricted securities by way of private resale without registration.

If the resale does not fulfill Rule 144 requirements, the law considers the resale to be “a distribution” when the securities holder resells restricted securities to the public. The “distribution” is equivalent to “public offering”.<sup>240</sup> However, the resale of restricted securities via private placement by the securities holder is not considered a distribution, so the securities holder therefore should not be considered an underwriter.<sup>241</sup> Nevertheless, even if the law does not consider a reseller to be an underwriter, Section 4(1) exemption is not applicable because

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<sup>240</sup> See COFFEE, *supra* note 236 at 544.

<sup>241</sup> See CHOI & PRITCHARD, *supra* note 190 at 630. (“If the control person is selling to an investor with the ability to fend for himself, there is no “distribution” within the meaning of Section 2(a)(11), and therefore no ‘underwriter’ in the control person’s transaction.”).



Section 4(1) applies only to transactions in the public market rather than private placement.

Courts do not consider the securities purchaser conducting private resale to be distribution, stating that such private resales may take advantage of Section 4(2) exemption.<sup>242</sup> In addition, courts should treat the reseller who does not intend to engage in a distribution like an investor trading securities in the market. Hence, the reseller should not be required to fulfill the obligation of registration. As a result, common law created the so-called “Section 4(a)(1 1/2)” exemption stating that the reseller is exempted from registration when conducting private resale.<sup>243</sup> On the other hand, such a situation is similar to Section 4(1), where the reseller is like a regular investor who does not have the obligation of securities registration.<sup>244</sup>

Notice that the subsequent purchaser should fulfill the requirements of qualifying the private placement purchaser—sophisticated persons.<sup>245</sup> If the subsequent purchaser can acquire and evaluate information from the issuer, the

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<sup>242</sup> Courts do not consider the securities purchaser conducting private placement to be a distributor, and therefore may take advantage of Section 4(2) exemption. *See* CHOI, *id.*

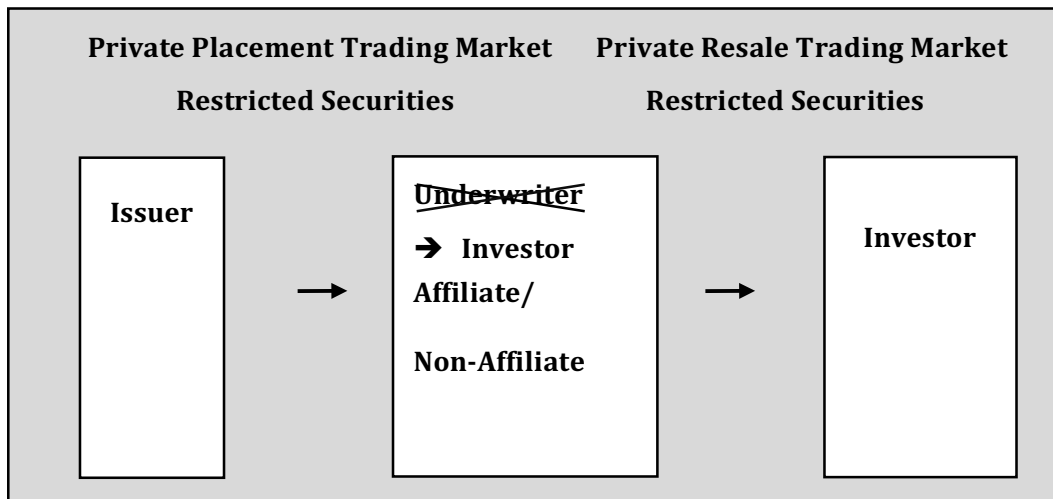
<sup>243</sup> *Id.*

<sup>244</sup> *See* CHOI & PRITCHARD, *supra* note 190 at 630. (“Technically, there is no Section 4(1 1/2) exemption. Instead, the Section 4(a)(1 1/2) exemption is a Section 4(1) exemption (with its emphasis on the definition of an underwriter) informed by Section 4(2)’s distinction between public and private offerings. If the control person is selling to an investor with the ability to fend for himself, there is no “distribution” within the meaning of Section 2(a)(11), and therefore no ‘underwriter’ in the control person’s transaction. The Section 4(1) exemption is therefore available to the control person”).

<sup>245</sup> *See* COX ET AL., *supra* note 231, at 503-04.

securities reseller will not be considered as an underwriter by courts.<sup>246</sup> See Chart 9 for an illustration of how the Section 4(a)(1 1/2) exemption works for the resale of securities.

**Chart 9: How the Section 4(a)(1 1/2) Exemption Works for the Resale of Restricted Securities in the Special Channel of Trading Market**



Source: Compiled by the Author

**(c) Private Resale to the QIB — Rule 144 A**

Rule 144 A provides an exemption for privately reselling restricted securities to subsequent purchasers who fulfil the conditions as “Qualified

<sup>246</sup> See HAZEN, *supra* note 231, at 126.

Institutional Buyers (“QIBs”), who do not necessarily fall under the statutory requirements of private placement purchasers.<sup>247</sup> This provides securities holders another channel in which to resell restricted securities via private resale in addition to the traditional private placement. It is also a good mechanism to facilitate the foreign issuer conducting fundraising in a more effective and efficient approach as opposed to the usual fashion, in which the issuer usually sells securities to an investment bank (acting as initial purchaser) which then resells to QIBs.<sup>248</sup>

The initial purchaser is acting as a middle man as the issuer’s fundraising tool. Additionally, the initial purchaser is sophisticated enough to protect itself and is intending to resell the securities as soon as possible for the convenience of fundraising.

In compliance with Rule 144A, resales to QIBs—or large institutional investors with securities portfolios in excess of \$100 million—are not public “distributions”, and consequently, the reseller of the securities is not an “underwriter”.<sup>249</sup>

Rule 144 A includes certain requirements, stating that (a) the issuer must give notice to the buyers that it is relying on Rule 144 A, (b) a holder of the

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<sup>247</sup> Rule 144A; 17 C.F.R. § 230.144A (2013). Regarding detailed requirements of QIBs, *see* CHOI & PRITCHARD, *supra* note 190, at 644.

<sup>248</sup> *See* BERMAN & EIGER, *supra* note 188, at 15.

<sup>249</sup> *Id.* at 14.

securities must have the right to request current information about the issuer from the issuer if the issuer is not a reporting company, and most importantly (c) the securities must not be of the same class as securities listed on a U.S. securities exchange.<sup>250</sup>

The securities offered can be debt securities, equity securities or ADRs. However, as stated above, the securities must not be of the same class as securities listed on a U.S. securities exchange,<sup>251</sup> because the law intends to distinguish the Rule 144A trading market and the public market of securities exchanges by protecting the same class securities from “fungibility”, or preventing the Rule 144A securities from being traded in securities exchanges.<sup>252</sup> Specifically, the issuer tends to issue debt securities in order to avoid fungibility.<sup>253</sup> Whether it is the same class of securities depends on whether the issuer issues the securities on the same date.<sup>254</sup> Therefore, the issuer may first issue and trade securities in accordance with the Rule 144A, and later list the same class of securities on a national securities exchange.<sup>255</sup>

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<sup>250</sup> See Bell, *supra* note 210, at 3.

<sup>251</sup> Whether the securities are the same class depends on if the securities are “substantially identical”. See J. WILLIAM HICKS, *RESALES OF RESTRICTED SECURITIES* 543 (2016 ED. 2016).

<sup>252</sup> COFFEE, *supra* note 240, at 553. (“Why is it that a small foreign issuer or a domestic, non-reporting company can use Rule 144A when IBM, Microsoft, and General Electric cannot?...The answer to this puzzle is that extending Rule 144A to listed securities was resisted because it would likely create a two-tier market, in which the listed stock would trade at one price on the NYSE or Nasdaq and at a slightly lower price in the Rule 144A market.”).

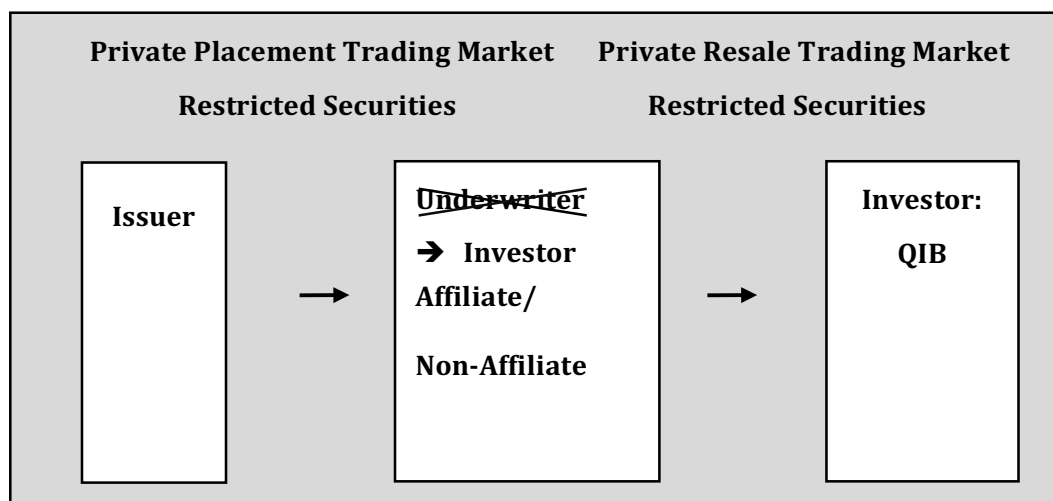
<sup>253</sup> BERMAN & EIGER, *supra* note 188, at 14.

<sup>254</sup> HICKS, *supra* note 251, at 541. (“[E]ligibility of securities for resale under Rule 144A is determined at the time securities are issued.”).

<sup>255</sup> *Id.* (“The significance of this test can be appreciated if one considers a company that issues a new class of securities in a private placement and then subsequently lists the class on a U.S. national securities exchange or arranges to have it quoted on the OTC-BB. Despite the public

Issuers usually construct Rule 144A offerings by first selling restricted securities to an initial purchaser in a private placement fashion exempt from registration; then, as Rule 144A permits, the initial purchaser can immediately resell these restricted securities to QIBs.<sup>256</sup> See Chart 10 for the illustration of how Rule 144A works for the resale of securities.

**Chart 10: How Rule 144A Works for the Resale of Restricted Securities in the Special Channel of Trading Market**



Source: Compiled by the Author

market that will develop from either of these decisions by the issuer, the privately placed securities, which were issued prior to the commencement of that trading, would continue to be eligible for resale in reliance on Rule 144A.”). See also Securities Act Release No. 6862 (April 23, 1990), 2013 WL 38367, at \*4.

<sup>256</sup> BERMAN & EIGER, *supra* note 188, at 15.

### c. Exemption for Both Issuer and Resale — Regulation S

Regulation S is an exemption available for securities offers and sales outside the U.S.,<sup>257</sup> Regulation S creates a special trading market in which issuers can transfer restricted securities outside the U.S. jurisdiction without interfering with the U.S. domestic market.<sup>258</sup> Regulation S provides two safe harbors respectively for the issuer and the resale.<sup>259</sup> Additionally, both the U.S. and the foreign issuer offering and selling securities outside the jurisdiction of the U.S. can apply to Regulation S.<sup>260</sup> Since Regulation S focuses on the examination of whether the securities are traded in the U.S., the subject of the transaction is not the point.

Under Regulation S, an offer, sale and resale of securities has to be an offshore transaction. Hence, any “direct selling efforts” made to the U.S. market are prohibited. That is, no issuer can extend an offer to a person in the U.S.<sup>261</sup>

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<sup>257</sup> Regulation S. Securities Act Release No. 33-6863, 17 C.F.R. 230.901-230.904 (1990).

<sup>258</sup> Therefore, Regulation S enables issuers conducting offshore insurance even to American investors. COFFEE, *supra* note 232 at 560. (“Regulation S, which was adopted in 1990, essentially reflects a shift from a ‘national’ approach focused on protecting U.S. nationals (whenever located) to a ‘territorial’ approach (which permits U.S. and foreign issuers to sell unregistered securities in foreign markets, even to U.S. nationals)”). However, even though Regulation S provides exemption from the Securities Act Section 5 registration, “it does not exempt the issuer from, among other regulations, Rule 10b-5 antifraud liability”. CHOI & PRITCHARD, *supra* note 190, at 599.

<sup>259</sup> *Id.* (“Structurally, Regulation S consists of a general statement (in Rule 901) and two specific safe harbors (in Rule 903 and 904). Rule 903 provides a safe harbor for participants in a distribution (referred to as ‘distributors’), including issuers, underwriters and selling group members. In turn, Rule 904 sets forth a safe harbor for resales by others, including investors who acquire securities in a U.S. private placement or in a transaction exempt from registration under Rule 144A.”).

<sup>260</sup> BERMAN & EIGER, *supra* note 188, at 18.

<sup>261</sup> *Id.*

Moreover, the “distribution compliance period” requirement prevents restricted securities transactions under Regulation S from “flowing back” to the U.S. market.<sup>262</sup> Generally, issuers cannot sell securities back to the U.S. during the distribution compliance period, and the issuer must fulfill the continuous reporting obligation. However, the transaction can combine Regulation S with Rule 144A.<sup>263</sup> Although Regulation S imposes a distribution compliance period during which purchasers cannot resell their securities to U.S. persons, Rule 144A provides a non-exclusive safe harbor for resales of Regulation S securities.<sup>264</sup> U.S. broker-dealers may purchase unregistered securities offered outside the U.S. under Regulation S and resell them in the U.S. to QIBs pursuant to Rule 144A during the distribution compliance period.<sup>265</sup> In addition, a QIB that acquired securities in a Rule 144A transaction can rely on Regulation S to resell the securities to any purchaser in an offshore transaction, provided that such resales do not involve in any US-directed selling efforts.<sup>266</sup> The law does not deem general solicitation in a Rule 144A offering to be “direct selling efforts” in respect to a related Regulation S offering,<sup>267</sup> because the Rule 144A facilitates the foreign issuer to conduct fundraising efficiently by creating a channel of a trading market that will not interfere with the domestic public market. See Chart 11 for

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<sup>262</sup> *Id.*

<sup>263</sup> CHOI & PRITCHARD, *supra* note 190, at 613. (“The anti-integration position of the SEC with respect to Regulation S allows the issuer to make concurrent Rule 144A/Regulation S offerings. See Securities Act Release No. 6863 (April 24, 1990).”); See also SCOTT ET AL., *supra* note 59, at 65.

<sup>264</sup> BERMAN & EIGER, *supra* note 188, at 19.

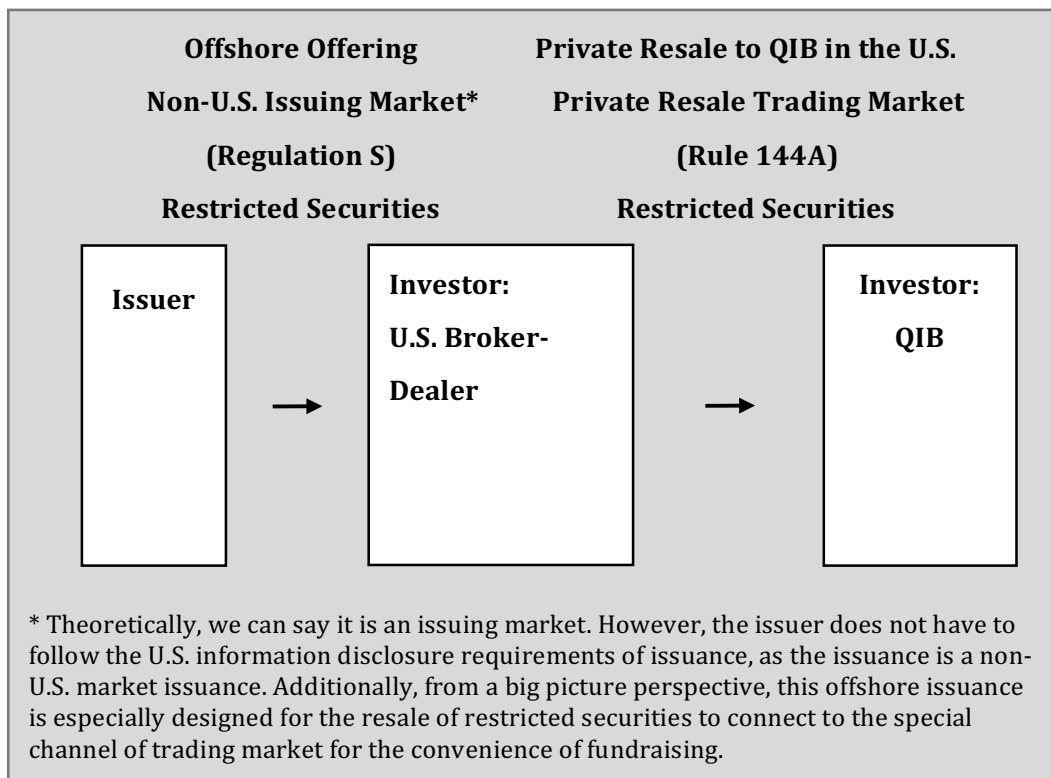
<sup>265</sup> *Id.*

<sup>266</sup> *Id.*

<sup>267</sup> *Id.*

an illustration of how the combination of Regulation S and Rule 144A works for the resale of securities.

**Chart 11: How the Combination of Regulation S and Rule 144A Works for the Resale of Restricted Securities in the Special Channel**



Source: Compiled by the Author

## (B) Exempted Securities

Certain kinds of securities issued by the government or banks are exempted from registration under the Securities Act because highly regulated entities issue these securities, guaranteeing that they will disclose enough information about



their business and operations to investors according to the relevant supervising regulations.<sup>268</sup> Exempted securities provide exemption at every transaction if the issuer belongs to the entity under statutory provisions. Therefore, securities holders can transact exempted securities freely in the trading market once the issuer issues the securities.

## **B. Listing and Trading Exemption**

As for listing and trading, there is one exemption from the Exchange Act registration if the issuer's primary trading market is in a foreign jurisdiction. Typically, nearly all issuers who register a sale of equity securities under the Securities Act also separately register the securities under the Exchange Act if they are selling securities on a securities exchange.<sup>269</sup> However, following the requirement of Section 12(g) of the Exchange Act, an issuer registering securities under the Exchange Act does not always conduct securities offerings and sales, which require registration under the Securities Act.<sup>270</sup> Specifically, if an issuer reaches a certain size with many investors of equality securities in accordance with Section 12(g) of the Exchange Act, the issuer is required to fulfill registration and report to the SEC. However, the issuer who registers equity securities under the Exchange Act pursuant to Section 12(g) does not usually make a public

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<sup>268</sup> Securities Act Section 3; 15 U.S.C. §77c (2012).

<sup>269</sup> Bell, *supra* note 210, at 7.

<sup>270</sup> *Id.*

offering that requires registration under the Securities Act.<sup>271</sup> Therefore, Rule 12g3-2 (b) provides an exemption if the issuer maintains a listing on one or more foreign markets constituting the primary trading market for the subject class of securities. Additionally, the issuer must publish, in English, on its website or through an electronic information delivery system, certain categories of information released since the first day of its most recently completed fiscal year.<sup>272</sup> With the Rule 12g3-2 (b) exemption, the issuer can avoid any registration obligation either under the Securities Act or the Exchange Act if the issuer does not conduct securities offering and sales, even if its investors of equality securities exceed certain numbers under the statutory provision of the Exchange Act.

## **2. Corporate Governance Member Installment and Internal Control Requirements**

In addition to the primary information disclosure obligation, the issuer has to comply with the corporate governance member installment and internal control requirements. However, the SEC has provided several rules for the foreign issuer to waive such installment and internal control requirements. We can discover that the point of regulation on the corporate governance member installment and internal control requirements is to set up a mechanism of procedural control in order to effectively supervise the decision-making body of

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<sup>271</sup> *Id.*

<sup>272</sup> *Id.*

the company, thereby preventing the directors from conducting unjust behaviors.<sup>273</sup>

### **3. Listing Standards on U.S. Exchanges**

In addition to the information disclosure obligation, the issuer has to fulfill the exchange's listing standards in order to list and trade its securities in such exchange. Securities exchanges require issuers to reach a level of economic capacity for listing, since listing on securities exchanges is an index of a successful business. Once the issuer fulfills the listing requirements, its securities can enjoy the liquidity of being traded in securities exchanges.

The two primary national securities exchanges in the U.S. include the New York Stock Exchange ("NYSE") and the NASDAQ Stock Market ("NASDAQ"). Although these two securities exchanges enact their own requirements of the listing standards, certain requirements are consistent with statutory obligations such as the corporate governance member installment and material information disclosure.<sup>274</sup>

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<sup>273</sup> In addition, the idea coming from the political theory of checks and balance reflects on the modern corporate governance philosophy. See Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991).

<sup>274</sup> The requirements of the listing standards on U.S. exchanges are enacted by securities exchanges themselves rather than the legislators. It is generally believed that only the company with a certain volume of issuance of securities can be traded in national securities exchanges.

### **III. Regulatory Standards for Securities Issuers**

The regulatory obligations for securities issuers build on a series of information disclosure requirements and include other relevant obligations including corporate governance member installment and listing standards on U.S. exchanges. Basically, U.S. regulation imposes the issuer with the information disclosure obligation in the process of securities issuance. However, the law also provides a series of exemptions, which the issuer may employ to increase fundraising efficiency. Furthermore, the regulator enacts several rules of safe harbors to reinforce the mechanism of exemptions and better facilitate special channels of trading markets for the issuer to avoid information disclosure requirements. The regulator created several rules such as Rule 144A and Regulation S especially for foreign issuers to enhance the capability of conducting fundraising more efficiently and effectively.

In addition to the exemptions that prevent the issuer from complying with the regulatory requirements, there is a lenient regulatory standard to relax the foreign issuer's burden of following these complicated and costly requirements. The regulatory standards for the domestic issuer and the foreign issuer are different. The SEC provides the foreign private issuer ("FPI") with a loose regulatory standard to avoid many tedious requirements with a policy of attracting foreign capital influx.

A foreign issuer has to fulfill certain requirements in order to become an FPI. Essentially, FPIs are companies established under foreign laws. However, the law

will deem a foreign company to be a U.S. company, and will be required to follow the disclosure standard of the U.S. issuer, if the ratio of the U.S. shareholders is too high.<sup>275</sup> The SEC sets up lenient rules for the FPI to decrease the cost of the disclosure obligation compliance. The U.S. securities exchanges also provide a lenient listing standard for the FPI. For example, an FPI can waive almost all corporate governance requirements even though it has to follow the same level of quantitative listing standards that domestic issuers follow. With a different level of regulatory standard, the SEC enhances the FPI's fundraising capability without endangering the interests of potential investors in the domestic market.

## **1. Information Disclosure Standards**

### **(1) Information Disclosure Standards Regarding Securities**

#### **Issuance**

##### **A. Immediate Information Disclosure—Registration Forms**

The principal forms used by foreign private issuers in registering with the SEC are Form F-1, F-2, F-3 and F-4. These four forms are roughly similar to Forms S-1 and S-3, which mainly U.S. domestic issuers use. Notice that Form F-1 is used by first time issuers. As for issuing ADRs, issuers take Form F-6.<sup>276</sup>

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<sup>275</sup> Securities Act Rule 405, 17 C.F.R. § 230.405 (2016); Exchange Act Rule 3b-4, 17 CFR 240.3b-4 (2016).

<sup>276</sup> SCOTT ET AL., *supra* note 59, at 24, 55.

The information required by the above registration forms can generally divide into three categories: (1) transaction-related information, including offering amount, use of proceeds, and underwriters; (2) company information; and (3) exhibits and undertakings.<sup>277</sup>

## **B. Ongoing Information Disclosure —Reporting Obligations**

Some important advantages that FPIs are entitled to enjoy in periodic information disclosure include the following:

Regarding current reports, the domestic issuer has to file a report on Form 8-K.<sup>278</sup> Conversely, the FPI has to disclose current reports either (1) after the information required by Form 6-K is made public by the issuer, (2) by the country of its domicile or under the laws of which it was incorporated or organized, or (3) by a foreign securities exchange with which the issuer has filed the information.<sup>279</sup>

An annual report has to be filed within six months of the end of issuer's fiscal year on form 20-F.<sup>280</sup> Both the FPI and the domestic issuer have to file annual reports using Form 20-F and Form 10-K respectively.<sup>281</sup> However, Form 20-F provides a later filing deadline for the FPI.

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<sup>277</sup> CHOI & PRITCHARD, *supra* note 190, at 402.

<sup>278</sup> Exchange Act Rule 13a-11, 17 C.F.R. 240.13a-11(2010).

<sup>279</sup> Exchange Act Rule 13a-16, 17 C.F.R. 240.13a-16 (2008).

<sup>280</sup> Exchange Act Rule 220f, 17 C.F.R. §249.220f (2005).

<sup>281</sup> Exchange Act Rule 310, 17 C.F.R. §249.310 (2005).

In addition, the domestic issuer is required to file quarterly financial reports on Form 10-Q, whereas the FPI is exempt from doing so.<sup>282</sup> Table 1 shows a comparison of the requirements of ongoing information disclosure.

**Table 1: Comparison of Requirements of Ongoing Information Disclosure between the U.S. Issuer and the FPI under U.S. Regulation**

	<b>The U.S. Issuer</b>	<b>The FPI</b>
<b>Current reports</b>	<b>Form 8-K</b>	<b>Form 6-K</b>
<b>Annual report filing</b>	<b>Form 10-K</b> within 60-90 days following the end of the fiscal year	<b>Form 20-F</b> Within six months of the end of the issuer's fiscal year
<b>Quarterly financial reports</b>	<b>10-Q</b> Must file a quarterly report	No need

Source: Compiled by the Author.

As for the non-period information disclosure, the domestic issuer has to report material information under Regulation FD,<sup>283</sup> while the FPI is exempt from Regulation FD.<sup>284</sup> Nevertheless, the FPI still has a duty to disclose material information under the rules of national exchanges.<sup>285</sup>

<sup>282</sup> Exchange Act Rule 13a-13(b)(2), 17 C.F.R. §240.13a-13(b)(2)(2008).

<sup>283</sup> Regulation FD, Rule 100-103; 17 C.F.R. Part 243(2014).

<sup>284</sup> Regulation FD, Rule 101(b); 17 C.F.R. §243.101(b)(2014).

<sup>285</sup> NYSE Rule 202.06 and NASDAQ Rule 5250(b). Bell, *supra* note 210 at n.76. ("The issuer must inform the staff of the applicable exchange of the substance of the announcement prior to the issuer's general disclosure of the announcement. The disclosure to the public must then be made through the fastest available means that complies with Regulation FD.").

### C. Information Disclosure Standards for an ADR Program

An American Depositary Receipt (“ADR”) program is a very convenient and efficient fundraising mechanic for the foreign issuer.<sup>286</sup> To establish an ADR program, an issuer will deposit shares of its common stock with a depositary bank in the U.S.<sup>287</sup> The depositary bank will then issue negotiable receipts—ADRs that are evidence of ownership of the deposited shares.<sup>288</sup> The use of ADRs permits the underlying securities to be traded through the U.S. trading and settlement system.<sup>289</sup> There are different levels of disclosure requirements to four types of ADR programs respectively.

A level one ADR program provides the foreign issuer with an efficient approach to depositing already-issued shares to the depositary bank, and investors trade their ADRs issued by the depositary bank in the over-the-counter (“OTC”) market.<sup>290</sup> The issuer then has to file an F-6 registration with the SEC. However, the issuer can ask for exemption from relevant reporting requirements of the Exchange Act under 12g3-2(b). Level one ADRs can be traded only in the OTC market rather than listed on any securities exchanges.<sup>291</sup> Since there are no

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<sup>286</sup> SCOTT ET AL., *supra* note 59, at 53-55.

<sup>287</sup> Bell, *supra* note 210 at 10.

<sup>288</sup> *Id.*

<sup>289</sup> *Id.*

<sup>290</sup> *Id.*

<sup>291</sup> *Id.*



new securities issued, A Level one ADR program cannot be used to raise new capital.<sup>292</sup>

A level two ADR program provides the foreign issuer to deposit already-issued shares to the depositary bank, and the foreign issuer lists the ADRs issued by the depositary bank on national markets.<sup>293</sup> Level two ADRs can be listed on securities exchanges. However, the issuer is not allowed to offer new securities to the public. Hence, there is still no fundraising capability on a level two ADR program.<sup>294</sup> The issuer has to file an F-6 registration and form 20-F as well with the SEC.

In addition to filing an F-6 registration and form 20-F, a Level three ADR is also required to file F-1 with the SEC because a Level three ADR is allowed to conduct securities public offers.<sup>295</sup> Although the foreign issuer can use Level three ADR to raise new capital, Level three ADR is the most expensive program with the most burdensome information disclosure obligation.

In addition to public offering, the foreign issuer can also use private placement with the mechanic of the Rule 144A trading market to raise capital.<sup>296</sup> Since the regulator enacted Rule 144A to facilitate the foreign issuer conducting

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<sup>292</sup> *Id.*

<sup>293</sup> *Id.*

<sup>294</sup> *Id.* at 11.

<sup>295</sup> *Id.*

<sup>296</sup> Guy P. Lander, *American Depositary Receipts*, 29 (4) INT'L L. 897, 913 (1995).

fundraising by way of private placement, ADRs are also allowed to be used through private placement with the Rule 144A approach. However, the securities issued with the use of Rule 144A approach must not be of the same class as securities listed on a U.S. securities exchange in order to prevent the securities from fungibility.<sup>297</sup> The system of Private Offerings, Resale and Trading through Automated Linkages (“PORTAL”) is designed for the trade of ADRs private placement with Rule 144A.<sup>298</sup> The cost is lower than the Level three program because it does not have to follow the registration requirement with the SEC, whereas the liquidity of securities trading in PORTAL is lower than trading in the public market. For a comparison of the requirements of different levels of ADRs, see Table 2.

**Table 2: The Comparison of the Requirements of Different Levels of ADRs**

	<b>Level one</b>	<b>Level two</b>	<b>Level three</b>	<b>Private Placement with Rule 144A</b>
<b>Registration</b>	Yes but Rule 12g 3- 2(b)	Yes	Yes	No
<b>SEC File Forms</b>	F-6	F-6 20-F	F-6, F-1 20-F	No

<sup>297</sup> See COFFEE, *supra* note 232 at 553.

<sup>298</sup> The PORTAL system, *see* SCOTT ET AL., *supra* note 59 at 44-45. However, there is a concern that Rule 144A private placements with its PORTAL trading system have increasingly come to resemble public offerings with the benefits of the public market but without the burdens and checks of registration and disclosure. SCOTT ET AL., *supra* note 59 at 45.

<b>Trading Markets</b>	OTC	NYSE, NASDAQ, AMEX	NYSE, NASDAQ, AMEX	PORTAL
<b>Securities Status</b>	Unlisted	Listed	Public Offering	Private Placement
<b>Fundraising Capability</b>	No	No	Yes	Yes

Source: Compiled by the Author with reference to the tables in Depository Receipts Handbook<sup>299</sup>

## **D. Accounting Principle Application**

### **(A) U.S. GAAP Reconciliation**

As for accounting principles, the SEC requires foreign issuers to report their financial information under the Exchange Act in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”).<sup>300</sup> In a typical case, foreign issuers use the accounting principle of their home country. Since the accounting principle foreign issuers use does not necessarily fall under U.S. GAAP, they have to spend time and money to make a reconciliation in order to fulfill the U.S. GAAP requirements; complying with U.S. GAAP is very costly and time-consuming.<sup>301</sup>

<sup>299</sup> Depository Receipts Handbook, *available at* [http://quantlabs.net/academy/download/free\\_quant\\_institutional\\_books\\_/\[Deutsche%20Bank%20Depository%20Receipts%20Handbook.pdf](http://quantlabs.net/academy/download/free_quant_institutional_books_/[Deutsche%20Bank%20Depository%20Receipts%20Handbook.pdf) (last visited. March 30, 2017)

<sup>300</sup> Regulation S-K (Item 10); 17 C.F.R. §229.10 (2011). Non-GAAP is discouraged.

<sup>301</sup> See Pat McConnell, *Practical Company Experience in Entering U.S. Markets: Significant Issues and Hurdles from the Advisor’s Perspective*, 17 *FORDHAM INT’L L.J.* S120, S126-27 (1994).

Since the U.S. GAAP reconciliation requirements will postpone the listing time for foreign issuers, foreign issuers have always intended to get the SEC to waive requirements. Thus, in the early 1990s, Daimler-Benz and some German companies negotiated with the SEC to waive the GAAP reconciliation.<sup>302</sup> Other German companies also argued with the SEC for a policy of mutual recognition regarding the different standards of accounting principles.<sup>303</sup> However, the SEC turned down the request by the prospective of investor protection, as those German companies did not meet the conditions of mutual recognition<sup>304</sup>—the disclosure obligation of German corporation law was not as stringent as U.S. securities laws, so they could not achieve their goal of U.S. investor protection.<sup>305</sup>

## **(B) Relaxation of GAAP**

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<sup>302</sup> SCOTT ET AL., *supra* note 59, at 38.

<sup>303</sup> *Id.*

<sup>304</sup> J. Hicks, *The Listing of Daimler-Benz A.G. Securities on the NYSE: Conflicting Interests and Regulatory Policies*, 37 GERMAN YEARBOOK OF INTERNATIONAL LAW 360, 384-85 (1994). The issue is whether the conditions for a policy of mutual recognition were met in the early 1990s with respect to German companies. Hence, we have to analyze if the conditions of mutual recognition are met. For the SEC to have adopted a securities law policy of reciprocity with Germany, it had to be convinced that both of the following conditions were satisfied: (1) German companies seeking to enter US securities markets under the policy were subject to certain minimum standards of disclosure and supporting regulation in Germany, and (2) any decreasing in the quantity or quality of disclosure by German issuers to U.S. investors, which would result from the SEC's decision to recognize German disclosure standards as controlling for German issuers involved in securities transaction in the United States, would not undermine investor confidence in the quality of the U.S. securities market or discriminate unfairly against U.S. issuers and intermediaries. Here, (1) there is no federal securities supervisory agency, such as the SEC, and (2) disclosure obligations of German corporation law, as mandated by EC Directives and as implemented in Germany, were not as stringent as those found in US securities law. Public investors did not receive the same information that German issuers shared with their major debt and equity holders. Therefore, the conditions of mutual recognition are not met.

<sup>305</sup> *Id.*

The position of the SEC—that considers U.S. GAAP as its only listing standard—has been widely criticized by foreign issuers. The SEC took U.S. GAAP as the only standard because from the standpoint of investor protection, U.S. GAAP is a comparable standard for investors to value the financial data from different companies.<sup>306</sup> However, some believe that it is improper to require a foreign company to make a U.S. GAAP reconciliation in order to list in a U.S. exchange. Even if financial information is submitted U.S. GAAP, it is difficult for investors to compare companies across nations, as different countries have different business practices.<sup>307</sup>

After Daimler-Benz negotiated with the SEC, German officials also claimed that in a market economy, the issue could be solved by competition even if German companies did not comply with the U.S. GAAP reconciliation.<sup>308</sup> The previous case of Nestle may support this claim. Nestle, a Swiss company, was listing in the U.S. pink sheet that did not require issuers to follow U.S. GAAP.<sup>309</sup> Even though Nestle did not provide GAAP-based information, Nestle obtained a great deal of trading volume in the U.S. by providing an increased level of disclosures.<sup>310</sup>

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<sup>306</sup> Demmo, *supra* note 16, at 711.

<sup>307</sup> *Id.* at 711-15.

<sup>308</sup> SCOTT ET AL., *supra* note 59, at 39. See also H. Beiner, *What Is the Future of Mutual Recognition of Financial Statements and Is Comparability Really Necessary*, 3 THE EUROPEAN ACCOUNTING REVIEW 335, 341 (1994).

<sup>309</sup> Demmo, *supra* note 16, at 711.

<sup>310</sup> *Id.*

Therefore, the SEC made certain concessions by accepting the International Accounting Standards (“IAS”) in April 1994. For example, the SEC relaxed the U.S. GAAP reconciliation requirements by permitting foreign issuers to file a cash flow statement prepared in accordance with IAS.<sup>311</sup> The Commission also accepted the use of IAS in lieu of U.S. GAAP reconciliation with respect to hyperinflationary accounting and certain business combinations.<sup>312</sup> Also, in 1995, the International Organization of Securities Commissions (“IOSCO”) and the International Accounting Standards Committee (“IASC”) announced a program to develop a set of accounting standards for companies seeking a listing in global markets.<sup>313</sup> IOSCO encouraged many European countries to follow the uniform standard on international accounting.<sup>314</sup> The SEC finally issued a Concept Release on International Accounting Standard determining under what conditions it would accept using IAS in lieu of U.S. GAAP.<sup>315</sup> Nowadays, the Exchange Act has facilitated foreign private issuers to take a lenient standard by accepting International Financial Reporting Standards (“IFRS”)<sup>316</sup> rather than rigorously requiring U.S. GAAP reconciliation.<sup>317</sup>

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<sup>311</sup> SCOTT ET AL., *supra* note 59, at 39.

<sup>312</sup> *Id.*

<sup>313</sup> *Id.* at 40.

<sup>314</sup> *Id.*

<sup>315</sup> *Id.* SEC Concept Release Nos. 33-7801, 34-42430 (Feb. 16, 2000).

<sup>316</sup> IFRS replaced IAS in 2001. IFRS website, *available at* <http://www.ifrs.org/Pages/default.aspx> (last visited April 18, 2017)

<sup>317</sup> SEC Release No. 33-8879 (Dec. 21, 2007).

## 2. Corporate Governance Member Installment and Internal Control Requirements

The SEC has provided several rules under which the FPI can waive installment requirements and internal control obligations, such as the following: (a) the FPI can waive the audit committee requirement by letting the board of directors replace the audit committee,<sup>318</sup> (b) the FPI can waive the need for internal control reporting filing on an annual basis, and <sup>319</sup> (c) executive compensation on an individual basis;<sup>320</sup> additionally, (d) directors and officers are exempt from reporting equity holdings and transaction in such holdings, and<sup>321</sup> (e) the FPI is exempted from proxy solicitation rules.<sup>322</sup> For a comparison of corporate governance member installment and internal control requirements between the U.S. issuer and the FPI, see Table 3.

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<sup>318</sup> SEC Release No. 33-8220 (April 9, 2003).

<sup>319</sup> SEC Release No. 33-8238 (June 5, 2003).

<sup>320</sup> 17 C.F.R. § 229.402 (2015); Form 20-F Item 6B.

<sup>321</sup> Exchange Act Rule 3a12-3(b); 17 C.F.R. §240.3a12-3 (1991).

<sup>322</sup> Exchange Act Rule 3a12-3(b); 17 C.F.R. §240.3a12-3 (1991).

**Table 3: The Comparison of Corporate Governance Member Installment and internal Control Requirements between the U.S. Issuer and the FPI**

	<b>The U.S. issuer</b>	<b>The FPI</b>
<b>Internal control reporting</b>	Quarterly basis	Annual basis
<b>Audit committee</b>	yes	No need/issuer’s entire board of directors may act as the audit committee
<b>Executive compensation</b>	yes	No need to disclose individual executive compensation
<b>Directors/officers, equity holdings</b>	yes	No need to report equity holdings and transactions in such holdings
<b>Proxy solicitation rules</b>	yes	No obligation to file proxy materials

Source: Compiled by the Author.

### **3. Listing Standards on U.S. Exchanges**

In addition to securities registrations and periodic reporting on the financial statements of business, foreign issuers must comply with the listing standards of the U.S. exchanges if they want to list their securities on U.S. exchanges. The NYSE and the NASDAQ have their rules respectively, which are NYSE Listed Company Manual (“NYSE Rules”) and NASDAQ Stock Market Rules (“NASDAQ Rules”). Generally, the rules of listing on the NYSE and the NASDAQ consist of several parts,



including (1) certain quantitative standards, (2) corporate governance, and (3) disclosure requirements.<sup>323</sup> There are also conditions under which the FPI can relax its standards, as well.

Complying with the rules of listing, a foreign issuer first applies to the exchange for the listing matters.<sup>324</sup> The issuer will be required to submit support documents for review.<sup>325</sup> It takes around four to twelve weeks to receive the result of application.<sup>326</sup> The SEC will approve the listing of securities once the review is finished.<sup>327</sup> The exchange will certify to the SEC of the listing.<sup>328</sup> Then, the issuer registers the securities with the SEC in accordance with the Exchange Act requirements.<sup>329</sup> That way, the issuer can trade their securities as long as they have certified the listing and completed registration.<sup>330</sup>

## (1) Quantitative standards

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<sup>323</sup> Bell, *supra* note 210, at 11-13.

<sup>324</sup> *Id.* at 11.

<sup>325</sup> *Id.*

<sup>326</sup> *Id.*

<sup>327</sup> *Id.*

<sup>328</sup> *Id.*

<sup>329</sup> *Id.*

<sup>330</sup> *Id.*

The quantitative standards include (a) distribution of shares, (b) trading (price), and (c) financial standards.<sup>331</sup> Further, the quantitative standards divide into quantitative listing standards and quantitative maintenance standards on both NYSE and NASDAQ.<sup>332</sup>

## **A. Quantitative Listing Standards**

There are two sets of quantitative listing standards under NYSE Rules.<sup>333</sup> The first set applies to both the domestic issuer and the FPI. The other one applies especially to the FPI. An FPI may choose either one of the two standards for listing. NYSE will ask an FPI to follow the same requirements if choosing the first set of the standard. On the other hand, the second set of the standard especially for the FPI is more demanding because its requirements are calculated by the worldwide basis. See Table 4 for the comparison of the requirements between the U.S issuer and the FPI under NYSE Quantitative Listing Standards. Table 5 is the summary comparison compiled by the author.

### **Table 4: The Comparison of the Requirements between the U.S Issuer and the FPI under NYSE Quantitative Listing Standards**

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<sup>331</sup> See *id.* at B-1, B-2 and C-1.

<sup>332</sup> *Id.* at 12.

<sup>333</sup> For a description of quantitative listing standards, see *id.* at B-1 and B-2.

<b>Types of Standards</b>	<b>NYSE Standard 1 for Both Domestic Issuers and FPIs</b>	<b>NYSE Standard 2 for FPIs Only (Worldwide basis)</b>
<b>Distribution Standards</b>	The issuer must have at least (a) 400 holders of 100 hundred shares or more, (b) 1.1 million publicly held shares, (c) an aggregate market value of USD 40 million, and (d) a per share price of USD 4.00 at the time of initial listing.	On a worldwide basis, the issuer must have at least (a) 5,000 holders of 100 shares or more, (b) 2.5 million publicly held shares, (c) an aggregate market value of USD 100 million, and (d) a per share price of USD 4.00 at the time of initial listing if listed in connection with an IPO.
<b>Financial Standards</b>	The issuer must also pass one of the following two financial tests:  (1) Earnings Test: The issuer must have earned a pre-tax income from continuing operations of at least (a) (i) USD 10 million in the aggregate for the last three fiscal years, (ii) USD 2 million in each of the two most recent fiscal years, and (iii) USD zero in each of the last three year fiscal years, or (b) (i) USD 12 million in the aggregate for the last three fiscal years, (ii) USD 5 million in the last recent fiscal year, and (iii) USD 2million in the next most recent fiscal year.	The issuer must also pass one of the following three tests:  (1) Earnings Test: The issuer must have earned a pre-tax income from continuing operations of at least (a) USD 100 million in the aggregate for the last three fiscal years and (b) USD 25 million in each of the two most recent fiscal years.  (2) Valuation/Revenue Test: The issuer must pass either:  (a) The “Valuation/Revenue with Cash Flow Test,” under which the issuer has (a) global market capitalization of at least USD 500 million, (b)

	<p>(2) Global Market Capitalization Test: The issuer must have at least USD 200 million in global market capitalization.</p>	<p>revenues of at least USD 100 million during the most recent 12 month period, (c) cash flows of at least (i) USD 100 million in the aggregate for the last three fiscal years and (ii) USD 25 million in each of the last two fiscal years; or</p> <p>(b) The “Pure Valuation” Revenue Test, under which the issuer has (a) global market capitalization of at least USD 750 million and (b) revenues of at least USD 75 million during the most recent fiscal year.</p> <p>(3) Affiliated Company Test: The issuer (a) has at least USD 500 million in global market capitalization, (b) has at least 12 months of operating history, (c) the issuer’s affiliate is a listed company in good standing, and (d) such affiliate retains control of the issuer or is under common control with the issuer.</p>
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Source: U.S. Securities Offerings and Exchange Listing by Foreign Private Issuers.<sup>334</sup>

<sup>334</sup> *Id.*

**Table 5: Summary Comparison between the U.S Issuer and the FPI under NYSE Quantitative Listing Standards**

<b>Types of Standards</b>	<b>NYSE Standard 1 for Both Domestic Issuers and FPIs</b>	<b>NYSE Standard 2 for FPIs Only (Worldwide basis)</b>
<b>Distribution Standards</b>	Low	High
<b>Financial Standards</b>	Low	High

Source: Compiled by the Author.

An issuer may also choose to list in NASDAQ Capital Market (NCM). There is no different standard between the U.S. domestic issuer and the FPI on NCM. See Table 6.

**Table 6: The Requirements of NASDAQ NCM Quantitative Listing Standards**

<b>Types of Standards</b>	<b>NASDAQ NCM Standard</b>
<b>Distribution Standards</b>	The issuer must have (a) a minimum bid price per share of USD 4.00 (or USD 2.00 or USD 3.00 under certain circumstances), (b) at least 1,000,000 publicly held shares, (c) at least 300 round lot holders, and (d) at least three registered and active market makers.
<b>Financial Standards</b>	The issuer must also pass one of the following three financial tests:  (1) Stockholders' Equity Standard: The issuer

	<p>must have (a) stockholders' equity of at least USD 5 million, (b) publicly held shares with a market value of at least USD 15 million, and (c) an operating history of at least two years.</p> <p>(2) Market Value of Securities Standard: The issuer must have (a) stockholders' equity of at least USD 4 million, (b) publicly held shares with a market value of at least USD 15 million, and (c) listed securities having a market value of USD 50 million.</p> <p>(3) Net Income Standard: The issuer must have (a) stockholders' equity of at least USD 4 million, (b) net income of at least USD 750,000 in either (i) the last fiscal year or (ii) two of the last three fiscal years, and (c) publicly held shares having a market value of at least USD 5 million.</p>
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Source: U.S. Securities Offerings and Exchange Listing by Foreign Private Issuers.<sup>335</sup>

## B. Quantitative Maintenance Standards

Regarding quantitative maintenance standards on NYSE and NASDAQ NCM, an issuer must meet distribution of shares, trading price, and financial standards on a continuous basis.<sup>336</sup> Issuers will be subject to suspension and delisting from exchanges if they do not fulfill requirements for maintenance standards. There is no distinction for the U.S. domestic issuer and the FPI in quantitative maintenance standards. See Table 7 for the requirements of NYSE quantitative maintenance

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<sup>335</sup> *Id.*

<sup>336</sup> For a description of quantitative maintenance standards, *see id.* at C-1.

standards; see Table 8 for the requirements of NASDAQ NCM quantitative maintenance standards.

**Table 7: The Requirements of NYSE Quantitative Maintenance Standards**

<b>Type of Standard</b>	<b>NYSE Quantitative Maintenance Standards</b>
<b>Distribution Standard</b>	The issuer has (a) fewer than 400 total stockholders, (b) fewer than 600,000 publicly held shares, or (c) (i) fewer than 1,200 total stockholders and (ii) an average monthly trading volume of fewer than 100,000 shares in the most recent 12 months.
<b>Pricing Standard</b>	The average closing price of the issuer’s shares over a 30-day trading period is less than USD 1.00.
<b>Financial Standard</b>	The issuer will (a) fail compliance standards if it has (i) less than USD 50 million in average global market capitalization over any 30-day trading period and (ii) less than USD 50 million in stockholders’ equity, and (b) immediately face suspension and delisting procedures if its average global market capitalization over any consecutive 30-day trading period is less than USD 15 million.

Source: U.S. Securities Offerings and Exchange Listing by Foreign Private Issuers.<sup>337</sup>

**Table 8: The Requirements of NASDAQ NCM Quantitative Maintenance Standards**

<b>Type of Standard</b>	<b>NASDAQ NCM Quantitative Maintenance Standards</b>
<b>Distribution Standard</b>	The issuer has (a) fewer than 500,000 publicly held shares, (b) less than USD 1 million in the market value of publicly held shares,

<sup>337</sup> *Id.*

	(c) fewer than 300 public stockholders, and (d) fewer than two registered and active market makers with respect to the shares.
<b>Pricing Standard</b>	The bid price per share of the issuer's equity securities is less than USD 1.00.

Source: U.S. Securities Offerings and Exchange Listing by Foreign Private Issuers.<sup>338</sup>

## (2) Corporate Governance Standards

The issuer must comply with standards regarding corporate governance, which may include such factors as director independence, audit committee, and matters related to shareholders. The FPI may choose their home country law as a following basis;<sup>339</sup> however, the FPI must comply with an audit committee fulfilling the requirements of Exchange Act Rule 10A-3,<sup>340</sup> an examination that determines director independence.<sup>341</sup> Also, if the FPI takes their home country practice as the following basis, they must identify in the annual reports on Form 20-F any material difference of the corporate governance practice on the FPI's home country from the U.S. practice.<sup>342</sup>

## (3) Disclosure Requirements

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<sup>338</sup> *Id.*

<sup>339</sup> NYSE Rule 303A, NASDAQ Rule 5615.

<sup>340</sup> NYSE Rule 303A.00, NASDAQ Rule 5615(a)(3)(A).

<sup>341</sup> Exchange Act Rule 10A-3, 17 C.F.R. § 240.10A-3.

<sup>342</sup> NYSE Rule 303A, NASDAQ Rule 5615. *See Bell, supra* note 210, at 12.



Both the NYSE and the NASDAQ require the FPI to file periodic reports with the SEC.<sup>343</sup> Issuers must provide certain information to the exchanges and to the public. First, the FPI has to disclose material information to the public in accordance Regulation FD if the information might be reasonably expected to affect the market or influence investors' decisions.<sup>344</sup> Additionally, the FPI is obligated to issue prior disclosure regarding specific events such as changes in the issuer's business and management.<sup>345</sup> Finally, the FPI has the financial disclosure obligation to deliver an income statement and an interim balance sheet on Form 6-K.<sup>346</sup>

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<sup>343</sup> For a description of disclosure requirements, *see* Bell, *supra* note 210, at 12-13.

<sup>344</sup> NYSE Rule 202.06, NASDAQ Rule 5250(b).

<sup>345</sup> NYSE Rule 204.01-204.25, NYSE Rule 802.03, NASDAQ Rule 5250(e), NASDAQ Rule 5810(b).

<sup>346</sup> NYSE Rule 203.03, NASDAQ Rule 5250(c)(2).

## **Chapter 4: Regulatory Structure Regarding Securities Issuance in Taiwan**

### **I. Overview**

This chapter conducts an overall examination of the current Taiwanese regulatory structure in order to find out the downsides of our current regulation so that we can provide concrete suggestions for future reformation.

As previously mentioned, securities regulation emphasizes the issuer's information disclosure. Hence, the regulatory structure develops from the information disclosure and its relevant obligations. In addition, since the regulator usually has a relaxed attitude towards foreign issuers, there is a different regulatory standard of information disclosure for the foreign issuer. By examining the different regulatory standards of information disclosure, we can better discuss the regulator's attitude in correspondence with theoretical analysis to establish a better future path of international securities regulation.

The regulatory structure of Taiwan mainly emulates the U.S. securities regulatory structure. In the year of 2012, lawmakers amended the Securities and Exchange Act to reinforce regulation on foreign issuers. However, many parts of the Securities and Exchange Act still need improvement. Therefore, this chapter sums up flaws through an examination of the current regulatory structure,

comparing it with the U.S. securities regulatory structure in order to prepare for the comparative discussion in the next chapter.

## **II. Regulatory Requirements for Securities Issuers**

### **1. A Preliminary Question—Mutatis Mutandis Application to the Securities and Exchanges Act**

The Securities and Exchanges Act<sup>347</sup> is the primary law regulating securities issuers in Taiwan. The Act consists of many rules, including issuance and transaction of securities in the capital markets. Before the amendment of the Securities and Exchange Act in the year of 2012, there was a problem if the foreign issuer applied to the Securities and Exchanges Act. According to the previous Article 4 of the Securities and Exchange Act—“[T]he term ‘company’ as used in this Act means a company limited by shares organized under the Company Act”<sup>348</sup>—it was unclear whether “company” included “foreign companies”.

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<sup>347</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] (2016); an English version of the Securities and Exchange Act is available on Laws & Regulations Database, *available at* <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=G0400001> (last visited Sep. 26, 2016).

<sup>348</sup> ZHENGQUAN JIAOYI FA (證券交易法) [Securities and Exchange Act] art. 4 (2010) (before the 2012 amendment).

In the past, the regulator could manage this problem by enacting sub-regulations or regulatory rules.<sup>349</sup> For example, according to Subparagraph 5 of paragraph 1 of Article 28-7 of Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, “[A] foreign issuer that applies for a TWSE primary listing of its stock...will continue to comply with ROC (Taiwan) securities laws and regulations, the listing contract, and the bylaws, rules, and public announcements of the TWSE.”<sup>350</sup> Furthermore, according to Paragraph 3 of Article 6-1 of Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Companies, “[A] TWSE primary listed company shall... engage a lead securities underwriter...in complying with the ROC (Taiwan) securities laws and regulations, TWSE rules and regulations, and the listing contract.”<sup>351</sup>

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<sup>349</sup> The discussion can be found in Chun-Pei Chang (張君珮), *Waiguo Gongsi Laitai Diyi Shangshi Fazhi Zhi Yanjiu (外國公司來台第一上市法制之研究)*[A Study of the Regulations of Overseas Issuers' IPO in Taiwan], 80-81 (2010) (unpublished LL.M. thesis, National Taipei University).

<sup>350</sup> TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI YOUJIA ZHENGQUAN SHANGSHI SHENCHA ZHUNZE (臺灣證券交易所股份有限公司有價證券上市審查準則) [Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings] art. 28-7, para. 1 sub.5 (2016), an English version of Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings is available on Law Source Retrieving System of Stock Exchange and Futures Trading, *available at* <http://eng.selaw.com.tw/LawArticle.aspx?LawID=FL007326&ModifyDate=1050519> (last visited Oct. 2, 2016).

<sup>351</sup> TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI WAIGUO FAXINGREN DIYI SHANGSHIHO GUANLI ZUOYE BANFA (臺灣證券交易所股份有限公司外國發行人第一上市後管理作業辦法)(Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Companies) art. 6-1, para.3 (2015), an English version of Taiwan Stock Exchange Corporation Rules for Regulating Primary Listed Foreign Companies is available on Law Source Retrieving System of Stock Exchange and Futures Trading, *available at* <http://eng.selaw.com.tw/LawArticle.aspx?LawID=FL047007&ModifyDate=1040902> (last visited Oct. 2, 2016).

However, it was questionable if lawmakers authorized the regulator to enact these kind of rules, because the Securities and Exchange Act did not clearly regulate foreign companies in the context of statute.<sup>352</sup>

After its amendment in January 4, 2012, the Securities and Exchange Act unanimously applies to domestic and foreign companies alike. There are two major points of its reformation: first, foreign companies are, for the first time, clearly addressed in the scope of regulation according to the new Article 4 of the Securities and Exchange Act; second, the Act allows foreign companies to apply *mutatis mutandis* to the management and supervision of the public offering, issuance, private placement, and trading of the securities pursuant to the new Article 165-1 and Article 165-2.

The wording of Paragraph 2 of Article 4, regarding the definition of foreign companies, demonstrates that foreign companies, without recognition of conducting public offering, issuance, private placement, and trading of the securities in Taiwan, apply to the regulations under the Securities and Exchange Act (“The term ‘foreign company’ as used in this Act means a company, for the purpose of profit making, organized and incorporated in accordance with the laws of a foreign country.” <sup>353</sup>).

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<sup>352</sup> Chang *supra* note 349.

<sup>353</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 4, para. 2 (2016).

The legislative reason of the 2012 amendment on the new Article 4 explained that:

[I]n order to establish internationalization of the securities markets, improve the supervision mechanism and investors protection, the legislators believed that foreign companies conducting public offering, issuance, private placement, and trading of the securities in Taiwan should be clearly regulated under the Securities and Exchange Act. Therefore, the legislators amended the paragraph 2 of article 4, stating foreign companies are under the regulatory scope by taking reference from Article 4 of the Company Act and Article 4 of the Business Mergers and Acquisitions Act.<sup>354</sup>

The legislators further assert that:

[I]t does not require recognition on foreign companies conducting public offering, issuance, private placement, and trading of the securities in the Taiwan market. For one thing, it does not require acknowledgement on foreign companies that have already incorporated in foreign countries in accordance with the Taiwan Business Mergers and Acquisitions Act. For another, Taiwanese companies issuing ADRs in the U.S. and GDRs in Japanese are not required recognition by the host countries. As a result, the legislators believe foreign companies are eligible to be regulated under the Securities and Exchange Act in view of the consideration of the principle of equality, and considering there is no substantial business

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<sup>354</sup> This dissertation explicitly expresses the intent of the 2012 amendment to Article 4 of the Securities and Exchange Act. For the original wording, *see* the online legal research system under the Legislative Yuan, *available at* <http://lis.ly.gov.tw/lglawc/lglawkm> (last visited Sep.26, 2016).

behavior except for the securities offering, issuance, private placement, and trading.<sup>355</sup>

More importantly, the Securities and Exchange Act amends chapter 5-1 of the regulations, especially when it comes to regulating foreign companies, allowing foreign companies to apply *mutatis mutandis* to the articles of management and supervision of the public offering, issuance, private placement, and trading of the securities.

Article 165-1, regulating the primary listing issuer, states that:

[W]hen stock issued by a foreign company has been approved for the first time by the stock exchange or over-the-counter securities exchange for listed trading on the stock exchange or over-the-counter market or for registration as emerging stock, if the issuer's stock is not traded on a foreign securities exchange, then, unless otherwise provided by the Competent Authority, the provisions of Articles....shall apply *mutatis mutandis* to the management and supervision of the public offering, issuance, private placement, and trading of the securities.<sup>356</sup>

The legislators believe that:

[I]n order to reach investors protection and enhance supervision mechanism, when the stock issued in Taiwan by a foreign company that has been approved for the first time by the securities exchange

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<sup>355</sup> *Id.*

<sup>356</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 165-1(2016).

or over-the-counter securities exchange for listed trading on the stock exchange or over-the-counter market or for registration as emerging stock, if the issuer's stock is not traded on a foreign securities exchange, the management and supervision requirements such as securities offering and issuance procedure, internal control system, independent directors establishment, the compose of audit committee, securities issuance declaration, periodic financial status report, information to be published in offering and issuance prospectuses shall be consistent with the regulations of domestic public traded company because issuer's stock has not been supervised by a foreign securities regulator before.<sup>357</sup>

Article 165-2, regulating the secondary listing issuer, states that:

[W]hen stock or securities representing stock issued by a foreign company other than under the preceding article is already traded on a foreign securities exchange, or the securities of a branch unit of a foreign financial institution or subsidiary of a foreign company meeting the requirements prescribed by the Competent Authority ("FSC") have been approved by the stock exchange or over-the-counter securities exchange for listed trading on the stock exchange or over-the-counter market, then, unless otherwise provided by the Competent Authority ("FSC"), the provisions of...[certain articles] shall apply *mutatis mutandis* to the management and supervision of the public offering, issuance, and trading of the securities in Taiwan.<sup>358</sup>

The legislators also assert that:

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<sup>357</sup> This dissertation explicitly expresses the intent of the 2012 amendment to Article 165-1 of the Securities and Exchange Act. For the original wording, *see* the online legal research system under the Legislative Yuan, *supra* note 354.

<sup>358</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 165-2 (2016).



[W]hen stocks or securities representing stocks issued by a foreign company is already traded on a foreign securities exchange, or the securities of a branch unit of a foreign financial institution or subsidiary of a foreign company meeting the requirements prescribed by the FSC have been approved by the stock exchange or over-the-counter securities exchange for listed trading on the stock exchange or over-the-counter market, the stock or securities has already been supervised by the foreign securities regulator. Hence issuers conducting public offering, issuance, private placement, and trading of the securities in foreign markets do not have to apply to the Securities and Exchange Act. Only the public offering, issuance, private placement, and trading of the securities in Taiwan will have to apply to the Securities and Exchange Act. In addition, foreign issuers are allowed to apply to foreign regulations if it is more favorable to the Taiwan investor protection.<sup>359</sup>

Table 9 shows the articles to which foreign issuers apply *mutatis mutandis*, regarding the management and supervision of the public offering, issuance, private placement, and trading of the securities.

**Table 9: The Articles under the Securities and Exchanges Act to Which Foreign Issuers Apply *Mutatis Mutandis***

Content	Number of Articles	Primary Listing Article 165-1 Applying <i>Mutatis Mutandis</i> To	Secondary Listing Article 165-2 Applying <i>Mutatis Mutandis</i>

<sup>359</sup> The dissertation explicitly expresses the intent of the 2012 amendment to Article 165-2 of the Securities and Exchange Act. For the original wording, *see* the online legal research system under the Legislative Yuan, *supra* note 354.

<b>Issuer</b>	5	✓	✓
<b>Definition of Securities</b>	6	✓	✓
<b>Definition of Issuance</b>	7	✓	✓
<b>Issuance</b>	8	✓	✓
<b>Prospectus</b>	13	✓	✓
<b>Financial Report</b>	14	✓	applicable to paragraph I and III
<b>Establishing Financial and Operational Internal Control Systems and Filing an Internal Control System Statement with the FSC</b>	14-1	✓	N/A
<b>Appointing Independent Directors</b>	14-2	applicable to paragraph I to III and IV	N/A
<b>Power of Independent Director</b>	14-3	✓	N/A
<b>Establishing either an Audit Committee or a Supervisor.</b>	14-4	applicable to paragraph I, II, V, VI.	N/A
<b>Power of Audit Committee</b>	14-5	✓	N/A
<b>Securities Fraud</b>	20	✓	✓
<b>Misrepresentation of Important Information</b>	20-1	✓	✓
<b>Securities Registration</b>	22	✓	✓
<b>Shareholding Fluctuation</b>	25	✓	N/A
<b>Information Required to be Provided in the Prospectus</b>	30	✓	✓
<b>Prospectus Delivery</b>	31	✓	✓
<b>False Information or Omissions in Prospectus</b>	32	✓	✓
<b>Periodic Disclosure and Financial Report</b>	36	✓	applicable to sub-paragraph I~VI
<b>Private Placement</b>	43-6	✓	N/A

<b>Restrictions on Private Placement</b>	43-7	✓	N/A
<b>Resell after Private Placement</b>	43-8	✓	N/A
<b>Transaction on a Centralized Securities Exchange Market</b>	150	✓	✓
<b>Manipulate Markets</b>	155	✓	✓
<b>Affecting the Market Trading Order</b>	156	✓	✓
<b>Short-Swing Transaction</b>	157	✓	✓
<b>Insider Trading</b>	157-1	✓	✓

Source: The Securities and Exchange Act in reference with the table on Zheng Jiao Fa Zuixin Zengbu.<sup>360</sup>

## **2. Information Disclosure Obligations**

### **(1) Information Disclosure Obligations Regarding Securities**

#### **Issuance**

#### **A. Ongoing Information Disclosure—Public Company Status**

##### **(A) Obtaining Public Company Status**

Under the current Taiwan regulatory structure, an issuer who intends to list its stock in the public market must first acquire the legal status of a “public company” before publicly offering securities. The status of the Taiwan public

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<sup>360</sup> Qiu Lushi (邱律師), *Zheng Jiao Fa Zuixin Zengbu*(證交法最新增補), available at [http://publish.get.com.tw/publish/Control/Pictures/BookAdd\\_pdf/51ML900602-1.pdf](http://publish.get.com.tw/publish/Control/Pictures/BookAdd_pdf/51ML900602-1.pdf) (last visited Oct. 17, 2016).

company is like the U.S. reporting company, which is responsible for issuing an ongoing disclosure obligation regarding the company's material information.

Logically, a company listing in the stock exchange market, a company listing at the over-the-counter market, and a company listing at the emerging stock market are all public companies.<sup>361</sup> However, a public company does not necessarily list in the stock exchange market, the over-the-counter market, or the emerging stock market.<sup>362</sup> In other words, a company that acquires the status of public company does not necessarily issue securities to the public.

Although we cannot directly find the definition of “public company”, we can infer from the articles in the Company Act and Securities and Exchange Act that an issuer has to fulfill the process of applying to the Competent Authority in order to become a public company before issuing securities to the public.<sup>363</sup>

According to Paragraph 3 Article 156 of the Company Act:

[A] company may, in pursuance of the resolution adopted by its board of directors, apply to the competent authority in charge of securities for an approval of public issuance of its shares. A company may apply for an approval of ceasing its status as a public company

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<sup>361</sup> See Chih-cheng Wang (王志誠), *Zhongri Gongkai Faxing Gongsu Neibu Zuzhi Fazhi Zhi Bijiao Fenxi* (中日公開發行公司內部組織法制之比較分析) [*The Legal System of Public Company: A Comparative Analysis of Internal Organization Regulation in Taiwan and Japan*], 15 ZHONGZHENG FAXUE JIKAN (中正法學集刊, 第十五期) [National Chung Cheng University Law Journal] 99, 103 (2004).

<sup>362</sup> *Id.*

<sup>363</sup> *Id.* at 104.

by a resolution adopted, at a shareholders' meeting, by a majority of the shareholders present who represent two-thirds or more of the total number of its outstanding shares.<sup>364</sup>

Further, if a “non-public company” intends to list its stock in the public market, it has to apply for approval of supplement procedures as a “public company.” According to Paragraph 1 Article 42 of Securities and Exchange: “[A]n issuer shall file an application with the Competent Authority (FSC) for commencement of the examination and approval procedures prescribed in this Act where it intends to have its stock that were not issued pursuant to this Act listed on a stock exchange or traded on over-the-counter markets.”<sup>365</sup>

Regarding the requirements of securities issuing, offering, and exchange in the public market, once a company becomes a public company, it has to follow the relevant rules about management scale, financial statement, restriction on insider trading of stocks, and disclosure standards pursuant to the Securities and Exchange Act.

## **(B) Whether the Foreign Issuer Should Obtain the Status of Public Company**

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<sup>364</sup> GONGSIFA (公司法)[Company Act] art.156, para. 3 (2015), an English version of the Company Act is available on Laws & Regulations Database, *available at* <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=I0080001> (last visited Sep.26, 2016).

<sup>365</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 42, para. 1 (2016).

The legal issue here regarding the foreign issuer is whether the foreign issuer has to apply for the legal status as a “public company” before listing in the public market, since the foreign company has to follow the relevant rules of the current Securities and Exchange Act.

Before the amendment of the Securities and Exchange Act, a foreign enterprise organized and registered under the law of a foreign country did not need to complete supplementary procedures for classification as a public company if the foreign issuer intended to list in a public exchange market of Taiwan, because this organization could not meet the definition of a “company” as set out in the Securities and Exchange Act.<sup>366</sup> The requirement that a non-public company must complete supplementary procedures for classification as a public company did not apply to a foreign company.<sup>367</sup> Furthermore, there was no provision nor rule for supplementary procedures for classifying a foreign company as a public company.<sup>368</sup> Therefore, a foreign company seeking to list in the public market was not a “public company”.

However, the amendment of Article 4 of the Securities and Exchange Act covers foreign companies as the regulatory subject. According to Article 165-1 and Article 165-2, foreign companies fall under the domain of Article 42—the

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<sup>366</sup> See TPEX Website, Foreign Issuer Listing (Registration) on the TPEX/ESM supplementary document, *FAQ: Are Foreign Enterprises Required to complete Supplementary Procedures for Classification as a Public Company in order to list in Taiwan* (Sep. 11, 2008), available at [http://www.tpex.org.tw/web/link/foreign\\_ipo.php?l=en-us#a06](http://www.tpex.org.tw/web/link/foreign_ipo.php?l=en-us#a06) (last visited May 1, 2016).

<sup>367</sup> *Id.*

<sup>368</sup> *Id.*

requirement of supplementary procedures for classification as a public company in order to obtain listing in the public market of Taiwan. Most importantly, according to the current Article 58 of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers:

[I]n the event that the foreign issuer intends to apply for listing on the stock exchange or for OTC trading of stock that has not been publicly issued under the Securities and Exchange Act, it shall submit the Registration Statement, specifying the required particulars, and annexing the required documents such as the stock issue prospectus, to the FSC to file for retroactive handling of public issuance procedures.<sup>369</sup>

Consequently, a foreign company has to acquire the legal status of a public company before the issuance and listing securities in the public market without a doubt.

### **(C) Disclosure Duty of the Public Company**

Once an issuer is approved as a public company, the company has a duty to perform public announcements about important information, and it must file with

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<sup>369</sup> WAIGUO FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (外國發行人募集與發行有價證券處理準則) [Regulations Governing the Offering and Issuance of Securities by Foreign Issuers] art. 58 (2015), an English version of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers is available on Laws & Regulations Database, *available at* <http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=G0400029> (last visited Sep.26, 2016).

the Competent Authority. The disclosure duty includes periodic disclosure and non-periodic disclosure.

### **a. Periodic Information Disclosure**

Regarding financial reports, the company should provide a report monthly, quarterly, and annually. In addition, the company must provide its operating status monthly in accordance with Paragraph 1 Article 36 of the Securities and Exchange Act.<sup>370</sup> Furthermore, upon registering the public issuance of its shares, a company shall file with the Competent Authority and announce to the public the class and numbers of the shares held by its directors, supervisors, managerial officers, and shareholders holding more than ten percent of the total shares of the company in accordance with Paragraph 1 Article 25 of the Securities and Exchange Act.<sup>371</sup> See Table 10 for the requirements of periodic information disclosure.

**Table 10: Requirements of Periodic Information for the Public Company under the Securities and Exchange Act**

<b>Periodic Information Disclosure (Basic Status of Information about the Company)</b>
Annual Report
Annual Financial Report
Quarterly Financial Report

<sup>370</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 36, para. 1 (2016).

<sup>371</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 25, para. 1 (2016).



Monthly Operating Status
Shareholding Fluctuation of the Affiliates

Source: The Securities and Exchange Act, and compiled by author.

## **b. Non-Periodic Information Disclosure**

The issuer should report to the Competent Authority if 1) the annual financial reports approved by the regular meeting of shareholders are inconsistent with the annual financial reports which the issuer has announced to the public and filed with the Competent Authority, or 2) any event takes place which has a material impact on shareholders' equity or securities prices, in accordance with Paragraph 3 Article 36 of the Securities and Exchange Act.<sup>372</sup> Additionally, issuers must disclose any major financial or operational actions of their public companies, such as the acquisition or disposal of assets, engaging in derivatives trading, extension of monetary loans to others, endorsements or guarantees for others, and financial projections. Furthermore, in the application for approval on public offering and securities issuance, an issuer must submit a prospectus and deliver it to the subscriber of securities prior to public offering, according to Article 30 and 31 of the Securities and Exchange Act.<sup>373</sup> See Table 11 for the requirements of non-periodic information disclosure.

### **Table 11: Requirements of Non-Periodic Information for Public Companies under the Securities and Exchange Act**

<sup>372</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 36, para. 3 (2016).

<sup>373</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 30(2016); ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 31 (2016).

<b>Non-Periodic Information Disclosure</b>
The annual financial reports approved by the regular meeting of shareholders if such reports are inconsistent with the annual financial reports which have been announced to the public and filed with the FSC.
Any event that has a material impact on shareholders' equity or securities prices.
Major financial or operational actions of public companies such as acquisition or disposal of assets.
Engaging in derivatives trading, extension of monetary loans to others.
Endorsements or guarantees for others disclosure of financial projections.

Source: The Securities and Exchange Act, and compiled by author.

## **B. Immediate Information Disclosure—Registration Obligation**

Article 22 of the Securities and Exchange Act provides rules about securities offer registration. According to article 22 of the Securities and Exchange Act: “[W]ith the exception of government bonds or other securities exempted by the Competent Authority (FSC), the public offering or issuing of securities without an effective registration with the Competent Authority shall be prohibited.”<sup>374</sup>

Under the current Taiwan regulatory system, the Securities and Exchange Act only requires a securities offering registration without securities listing and trading registration. The article requires a registration for public offering or issuing of securities because there is no registration requirement for the private

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<sup>374</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 22 (2016).

placement. Moreover, the article requires registration for issuing the securities because material information has not fully disclosed before the securities issuance is complete. Therefore, the registration obligation of article 22 includes the situation when the underwriter helps the issuer to sell and distribute securities.

Lawmakers referred to the U.S. Securities Act of 1933 when amending Article 22 of the Securities and Exchange Act to include the requirement of securities registration.<sup>375</sup> In the past, the Securities and Exchange Act imposed a substantial scrutiny (or “substantial review”) on the application for securities registration—the Competent Authority not only reviewed the documentation of the application but also substantially examined whether the issuer’s business quality reached certain standards. However, the substantial scrutiny requirement negatively affected investors, forcing them to rely on the scrutiny of the Competent Authority regarding securities investment decision, and therefore resulting in an unrealistic expectation on the Competent Authority.<sup>376</sup> For example, the Competent Authority approved a company called Wan-Yi for securities issuance; <sup>377</sup> however, Wan-Yi ended up declaring for bankruptcy two months later. The investors then blamed the Competent Authority, claiming a negligence of duty of careful scrutiny, because the investors initially believed the

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<sup>375</sup> LIAN-YU LIU(劉連煜), XIN ZHENGQUAN JIAOYIFA SHILI YANXI (新證券交易法實例研習) 226 (14th ed. 2016)(Taiwan).

<sup>376</sup> *Id.* at 94.

<sup>377</sup> *See id.* The aftermath of the Wan-Yi (“丸億”) case resulted in the legislative amendment on Article 22 of the Securities and Exchange Act to abandon the approach of substantial scrutiny. *See* also IN-JAW LAI (賴英照), ZHENGQUAN JIAOYIFA ZHUTIAO SHIYI VOL 4 (證券交易法逐條釋義 第四冊)118-19 (1992)(Taiwan).

Wan-Yi company should have been a good quality company after the Competent Authority approved it to issue securities.<sup>378</sup> Nevertheless, scholars believe that the Competent Authority should not have been responsible for investors' investment decision making.<sup>379</sup> Despite the fact that investors have to rely on their own judgment and take risks on the investment themselves, the merits of the simple registration process increase the efficiency of fundraising and decrease the burden of the Competent Authority on reviewing applications. Consequently, in 2006, lawmakers amended Article 22 of the Securities and Exchange Act to take the approach of "simple registration," using the U.S. Securities Act of 1933 as reference.<sup>380</sup>

According to the current Article 22, the issuer files an application with the FSC by providing necessary documentation. The application becomes automatically effective certain business days after the FSC receives the application.<sup>381</sup> According to Article 22, it seems that the current registration process no longer requires a substantial review on the capability of the issuance and the issuer's business, and thus does not require an affirmative approval for the issuance of the securities by the FSC. However, Article 4 of Regulations Governing the Offering and Issuance of Securities by Securities Issuers, which is

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<sup>378</sup> *Id.*

<sup>379</sup> LIU, *supra* note 375, at 95.

<sup>380</sup> *Id.* at 97.

<sup>381</sup> FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (發行人募集與發行有價證券處理準則)[Regulations Governing the Offering and Issuance of Securities by Securities Issuers] art.3, para 2 (2015), an English version of Regulations Governing the Offering and Issuance of Securities by Securities is available on Laws and Regulations Database, available at <http://law.moj.gov.tw/Eng/LawClass/LawContent.aspx?PCODE=G0400023> (last visited March 30, 2017).

the regulations governing the registration process of securities issuance authorized by the Securities and Exchange Act, states that the issuance is prohibited under certain conditions regarding the concern of the company's business status and quality.<sup>382</sup> Therefore, scholars believe that the current regulatory structure does not take the approach of "pure" simple registration.<sup>383</sup> Even though the substantial scrutiny may provide more protection for investors to some extent, it may be a fundraising obstacle for the issuer who is not risk-averse, but rather an honest company.<sup>384</sup>

## **(2) Exemptions from Information Disclosure Obligations**

The situations that merit exemptions from the information disclosure obligation can be also divided into exempted transactions and exempted securities. Exempted transactions are the focus of the discussion since the law created complicated mechanisms to allow restricted securities to be transacted in the designed channel.

### **A. Exempted Transactions**

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<sup>382</sup> FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (發行人募集與發行有價證券處理準則)[Regulations Governing the Offering and Issuance of Securities by Securities Issuers] art.3, para 2 (2015).

<sup>383</sup> See LAI *supra* note 377 at 124. Professor Lai believes that the current regulatory structure is at most building up a foundation for the approach of simple registration. LIU, *supra* note 375 at 95-96.

<sup>384</sup> See SYUE-MING YU (余雪明), ZHENGQUAN JIAOYI FA (證券交易法)168 (2000)(Taiwan).

In the situation when the securities registration is exempted, the law creates a special channel of a trading market that allows restricted securities to be traded in such a channel under certain conditions. The issuance exemption initiates a channel of a kind of specific trading market that lets the issuer transfer restricted securities in an efficient way. The resale exemption helps securities holders to continuously transfer restricted securities in this channel.

In Taiwan, the regulatory structure of securities exemptions is similar to the U.S. The law initiates a channel of a kind of a trading market via the regulation of private placement. To help securities holders to continuously transfer restricted securities in that special channel after the initiation via private placement, the law also amends certain relevant resale exemptions to facilitate the liquidity of securities under the use of the resale exemptions.

## **(A) Exempted Transaction from Securities Offering Registration**

### **a. Issuance Exemption—Private Placement**

In Taiwan, the Securities and Exchange Act provides an exemption from registration if an issuer (in the initial market), as a public company, conducts private placement to certain subjects of purchasers. The rationale behind the rule of private placement under the Securities and Exchange Act in Taiwan is the same as the U.S. rule, stating that the purchasers of the private placement securities must be capable of acquiring securities information in the capital markets because they are financially powerful and well-experienced, and thus do not need much

protection. An issuer conducting private placement is not required to deliver prospectus to the purchasers, and the issuer is not required to register the securities. The issuer has only to submit the relevant documentation in a report to the FSC for recordation within 15 days of the date in which they submitted in full the share payments or payments of the price of the corporate bonds under Article 43-6 of the Securities and Exchange Act.<sup>385</sup> Private placement is a good approach to offering issuers an efficient way to raise funds. Article 43-6 is the rule of private placement exemption.

Certainly, private placement is exempted from the securities registration. However, issuers must still fulfill certain requirements, including the amount and the purchasers of private placement. As for purchasers, only three kinds of people are eligible to become private placement places. These people are similar to the concept of “accredited investors” under the U.S. law, which includes such entities as: (1) Banks, bills finance enterprises, trust enterprises, insurance enterprises, securities enterprises, or other juristic persons or institutions approved by the Competent Authority; (2) Natural persons, juristic persons, or funds meeting the conditions prescribed by the Competent Authority; and (3) Directors, supervisors, and managerial officers of the company or its affiliated enterprises.<sup>386</sup>

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<sup>385</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-6 (2016).

<sup>386</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-6, para. 1(2016).

Also, the total number of places under items (2) and (3) shall not exceed 35 persons.<sup>387</sup> As for the amount of the placement, if the issuer conducts ordinary corporate bonds, a total issue amount shall not exceed 400 percent of its total assets less total liabilities, unless the FSC has obtained the approval of the central authority with jurisdiction over the business of the company.<sup>388</sup> Likewise, even though the issuer has no obligation to register securities, the issuer has to keep the private placement purchaser to access the information.<sup>389</sup>

Under the current regulatory structure, only the issuer who acquires the legal status of public company is allowed to conduct private placement of equity securities pursuant to the regulations under the Securities Exchange Act.<sup>390</sup> A Non-public company or a so-called “Closely Held Company” may only conduct an issuance of new shares process to its own shareholders, or it may conduct a private placement of corporate bonds to a limited number of purchasers without securities registration pursuant to the relevant regulations under the Company Act.<sup>391</sup>

## **b. Resale Exemption**

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<sup>387</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-6, para. 2(2016).

<sup>388</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-6, para. 3(2016).

<sup>389</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-6, para. 4(2016).

<sup>390</sup> Article 43-6, para. 1 of Securities and Exchange Act specifies that only a public company may carry out private placement of securities.

<sup>391</sup> GONGSIFA (公司法)[Company Act] art. 248, para. 2(2015).



As mentioned before, the purpose of the resale exemption is to aid the securities holder to continuously transfer restricted securities in a special channel of trading market. In addition, resale exemption provides some criteria that prevents the securities transferred by the reseller from being considered as “Secondary Distribution”. This way, we will not consider the securities reseller to be the underwriter under certain resale transaction requirements. Just like Rule 144, Section 4(a)(1 1/2), and Rule 144A in the U.S., there are similar regulations regarding resale exemptions in Taiwan.

### **(a) Resale to the Public**

Securities holders cannot resell restricted securities from the special channel of the trading market to the public until the information is fully disclosed or the initial purchaser holds the securities for a period of time. Additionally, if the reseller is an affiliate of the issuer, we must exam whether the resale fulfills certain dribble-out selling requirements, so that we will not deem the affiliate to be an underwriter.

Subparagraphs 1 and 2 of paragraph 1 of Article 22-2 of the Securities and Exchange Act cover the resale regulation of affiliate holders. Subparagraph 1 discusses the situation of conducting securities distribution when the affiliate must comply with securities registration in reselling its securities to the public, because we would deem the affiliate to be the underwriter engaging in the securities distribution. Since the affiliate has controlling power in the company,

we consider the securities resale by the affiliate the same way we consider the issuer selling the securities, so the affiliate must also fulfill registration.

Sub-paragraph 1 of Article 22-2 of the Securities and Exchange Act states:

The transfer of stocks by the directors, supervisors, managerial officers, or shareholders holding more than ten percent of the total shares of an issuer under this Act shall be effected in accordance with...an offering to the public following approval from or an effective registration with the Competent Authority.<sup>392</sup>

This sub-paragraph suffers from disadvantageous wording. Since information is required by way of “registration” only pursuant to Article 22, the “approval” referring to substantial scrutiny is outdated and should be deleted from the sentence of this sub-paragraph.<sup>393</sup>

The second sub-paragraph discusses the safe harbor for affiliates who freely resell the securities to the public under certain conditions, including the holding period and the volume limitation of transaction prescribed by the FSC without securities registration:

The transfer of stocks by the directors, supervisors, managerial officers, or shareholders holding more than ten percent of the total shares of an issuer under this Act shall transfer, at least three days

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<sup>392</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 22-2, para. 1, sub. 1(2016).

<sup>393</sup> See Chuang, *supra* note 11, at 60.

following registration with the Competent Authority, on a centralized exchange market or an over-the-counter market, shares that have satisfied the holding period requirement and within the daily transfer allowance ratio prescribed by the Competent Authority. However, this requirement shall not apply to transfers totaling less than 10,000 shares per exchange day.<sup>394</sup>

Like Rule 144 in the U.S., sub-paragraph 2 provides affiliate holders an opportunity to be considered as an investor rather than an underwriter under the conditions of “dribble-out” or trading volume limitation and securities holding period restriction. If the resale fulfills the requirements of the holding period and volume limitation, securities registration should not be required because the information would be considered as disclosed to the public after the affiliate holder fulfills requirements.<sup>395</sup> Therefore, the current regulation requiring registration even after affiliate holders fulfill the requirements of the holding-period and the volume limitation is improper.

For the requirement of the resale volume limitation, the FSC Securities and Exchange Rule No. 1040006799 provides a rule that covers the holding period requirement and the daily trading volume limitation.<sup>396</sup> However, the rule does not distinguish between restricted and non-restricted securities. Therefore, this

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<sup>394</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 22-2, para. 1, sub. 2 (2016).

<sup>395</sup> *Supra* note 224, The lapse of time justifies the way of information disclosure, as the holding period of restricted securities is always necessary before the resale of securities to the public; *supra* note 231 the low volume of securities resale justifies the way that the reseller is an ordinary investor.

<sup>396</sup> JINGUAN ZHENGJIAO ZI DI 1040006799 HAO (金管證交字第 1040006799 號) [The FSC Securities and Exchange Rule No. 1040006799](2015).

dissertation suggests drawing a distinction between restricted and non-restricted securities taking the reference of Rule 144.

As for the non-affiliate holder reselling restricted securities to the public, Subparagraph 3 of Paragraph 1 of Article 43-8 provides a three-year holding period for reselling restricted securities from private placement.<sup>397</sup> There is no further restriction regarding dribble-out, since we know the volume limitation of resale is associated with the affiliate holder. However, the requirement regarding the term of holding period is defective. Looking back to the U.S. framework, Rule 144 distinguishes the non-affiliate and the affiliate holder, and Rule 144 gives each person a holding period of six months and one year respectively. In Taiwan, we do have a special rule for the affiliate holder to carry out resale to the public after one year holding of restricted securities, pursuant to Subparagraph 2 of Article 22-2; however, the resale of the non-affiliate holder has to follow the three-year holding period under Sub-paragraph 3 of Article 43-8. Therefore, the current rule of the holding period seems too long for the non-affiliate holder compared to U.S. Rule 144.<sup>398</sup>

### **(b) Private Resale**

The law facilitates a special channel of a trading market in which the initial purchaser holding restricted securities may conduct private resale to accredited

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<sup>397</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-8, para. 1, sub. 3 (2016).

<sup>398</sup> See Chuang, *supra* note 11, at 59-60.

investors immediately. There is no distinction between the affiliate or non-affiliate conducting private resale because we are not concerned about whether there is any securities distribution situation under private resale. However, in Taiwan, the law regulates affiliate and non-affiliates respectively regarding private resale. The legislators are more concerned about the affiliate's transaction so that the regulation of the affiliate is independent from the regulation of the non-affiliate. Private resale by the affiliate is regulated under sub-paragraph 3 of paragraph 1 of Article 22-2, whereas the law regulates private resale by non-affiliate under Sub-paragraphs 1 and 2 of paragraph 1 of Article 43-8.

In Taiwan, affiliates adhere to the following regulations listed under Subparagraph 3 of paragraph 1 of Article 22-2 (conducting private placement resale exemption):

The transfer of stocks by the directors, supervisors, managerial officers, or shareholders holding more than ten percent of the total shares of an issuer under this Act shall be effected... within three days following registration with the Competent Authority, by means of private placement to designated persons satisfying the qualifications prescribed by the Competent Authority.<sup>399</sup>

According to the FSC Securities and Exchange Rule No. 1000040523, the designated persons must correspond with the “accredited investors” in accordance with the requirements of Article 43-8. Therefore, the effect of the

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<sup>399</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 22-2, para. 1, sub. 3 (2016).

affiliate or the non-affiliate conducting private resale is essentially the same. The law permits resale to the “accredited investors” under a couple of situations, pursuant to the mutatis mutandis application in Article 43-8.<sup>400</sup>

In the first situation, financial institutions may transfer restricted securities to other financial institutions who meet the same qualifications if there is not a same class of securities traded on a securities exchange.<sup>401</sup> This rule is very similar to both Section 4(a)(1 1/2) exemption and Rule 144A. However, there is not a fine regulatory structure because we only allow financial institutions to sell to other the financial institutions that meet the same qualifications.<sup>402</sup> Compared to the U.S. structure of the Section 4(a)(1 1/2) exemption and Rule 144A, which include detailed requirements and more options of channels of trading markets, the current rule of Taiwan is very rough and restricted.

Second, securities holders may resell restricted securities to the purchasers of certain accredited investors prescribed by the Competent Authority by way of transaction with the restriction of the holding period and the trading volume limitation.<sup>403</sup> Compared to the U.S. resale via private placement, there is no

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<sup>400</sup> JINGUAN ZHENGJIAO ZI DI 1000040523 HAO (金管證交字第 1000040523 號) [The FSC Securities and Exchange Rule No. 1000040523](2011).

<sup>401</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-8, para. 1, sub. 1 (2016).

<sup>402</sup> There is one thing worth noticing for the private resale exemption: under the U.S. law, there is an additional private resale approach of resale to the purchaser of QIBs under Rule 144A in addition to the purchasers of “accredited investors” or “non-accredited investors” out of the traditional channel of the private placement regulation.

<sup>403</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 43-8, para. 1, sub. 2 (2016).

further restriction regarding the holding period and the trading volume limitation under the Section 4(a)(1 1/2) exemption and 144A . In the U.S., the reseller is able to conduct private placement directly with the subsequent purchaser without the restrictions of the holding period or the trading volume limitation because the law facilitates a special channel allowing resellers to trade restricted securities freely. The holding period and the trading volume limitation transform restricted securities into non-restricted securities. After resellers fulfill the requirements of the holding period and the trading volume limitation, restricted securities become non-restricted securities that resellers can trade in the public freely. On the other hand, in the special channel that facilitates the transferal of restricted securities, such requirements are not necessary.<sup>404</sup>

There are also a few downsides under the current regulation:

First, under paragraph 2 of Article 22-2, for the subsequent purchaser who purchases securities from the affiliate, there is a one-year holding period for securities before the subsequent purchaser may trade them to the public, because we believe that the securities purchased from the affiliate are restricted securities.<sup>405</sup> However, the FSC Securities and Exchange Rule No. 1000040523 suggests applying the regulation of sub-paragraph 3 of paragraph 1 of Article 43-8, stating that the affiliate may freely transfer securities to the subsequent purchaser after a three-year holding period.<sup>406</sup> The problem is whether the

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<sup>404</sup> See Chuang, *supra* note 11, at 58.

<sup>405</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 22-2, para. 2 (2016).

<sup>406</sup> *Supra* note 400.

subsequent purchaser still has to follow the one-year holding period if the affiliate has held the securities for three years and then transferred the securities to the subsequent purchaser.<sup>407</sup> Here, restricted securities have already become non-restricted period after three years of holding by the affiliate.<sup>408</sup> In such cases, there is no need to impose the subsequent purchaser to follow the one-year holding period restriction because the securities the subsequent purchaser purchases from the affiliate are non-restricted securities.

Besides, the affiliate should not have to register the securities under private placement pursuant to sub-paragraph 3 of paragraph 1 of Article 22 because the designated persons are capable of protecting themselves from information asymmetry. Since private placement transaction does not require registration, scholars suggest that the registration requirement under this sub-paragraph should be deleted.<sup>409</sup>

Finally, Article 43-8 covers the resale of securities by non-affiliates via private placement; however, there is no need to distinguish between the affiliate or the non-affiliate conducting private resale because we are not concerned about whether there is a securities distribution situation under private resale. Besides, two situations of private resale under Article 43-8 incur exactly the same

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<sup>407</sup> See Ming-Chiu Yie (易明秋), *Lun Zhengquan Shichang Zaici Faxing Zhi Guanli* (論證券市場再次發行之管理)[*Regulation of Secondary Distributions in the Stock Market*], 18(1) DONGWU FALU XUEBAO [Soochow Law Review](東吳法律學報) 91, 124-25 (2006).

<sup>408</sup> See Chuang, *supra* note 11, at 58-60.

<sup>409</sup> See Chuang, *supra* note 11, at 57.



problems as the previously mentioned situations happening to the affiliate conducting private resale. Thus, lawmakers should revise the regulation under this article.

## **B. Exempted Securities**

Just as the U.S. provides regulations of the exempted securities, there is also an affirmative rule of the exempted securities pursuant to the current Securities and Exchange Act. Scholars argue that Paragraph 1 of Article 22 provides the approach of the exempted securities by stating: “With the exception of government bonds or other securities exempted by the Competent Authority...”<sup>410</sup> Therefore, the law exempts certain kinds of issuers as well as securities issued by the government from registration.

## **3. Corporate Governance Member Installment and Internal Control Requirements**

Article 14-1 through 14-6 of the Securities and Exchange Act offer regulations for corporate governance member installment and internal control requirements in order to improve the efficiency and soundness of corporate governance of public companies. Referring to U.S. law, the installment includes independent directors, supervisors or the audit committee, the remuneration

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<sup>410</sup> See YU, *supra* note 11, at 308-09.

committee, and relevant internal control mechanisms. The issuer should follow relevant operational procedure regarding the corporate governance regulations. Additionally, the issuer should file an internal control system statement with the Competent Authority within three months of the close of each fiscal year.

## **4. Listing Standards on Taiwan Exchanges**

The issuer has to follow the listing standards on stock exchanges in order to trade and list its securities in such exchanges. The securities exchanges in Taiwan have their own characteristics. The following text introduces the Taiwanese exchanges structure.

### **(1) Securities Exchanges Structure**

In Taiwan, the primary two markets of securities exchanges are the Taiwan Stock Exchange Corporation (“TWSE”) and the Taipei Exchange (“TPEX”). The market on which issuers may trade securities without listing on the TPEX is called the “emerging securities market”.

#### **A. The TWSE Market**

The TWSE is the primary stock exchange in Taiwan. Companies of large business scale tend to list in the TWSE. Due to the large amount of transactions

every day, the transaction of stock in the TWSE takes place by way of call-auction via computer automatic operation.<sup>411</sup> Naturally, the price of stocks dealing in the TWSE is more transparent. The liquidity of stocks exchanged in the TWSE is the highest, as companies listing their stocks in the TWSE have to comply with a strict disclosure standard.

## **B. The TPEX Market**

The Taipei Exchange (TPEX) is in fact an over-the-counter market where securities brokers exchange stocks in business counters. Small- and medium-sized companies may choose to list their stock in the TPEX, since the requirements of listing in the TPEX are not as demanding as listing in the TWSE. Therefore, we can consider the TPEX to be the NASDAQ of Taiwan, and the TWSE to be Taiwan's NYSE.<sup>412</sup> Notice that companies who intend to list their stocks in either the TWSE or the TPEX must first apply to become a "public company," as it is the basic requirement for trading securities in the public market.

## **C. Emerging Securities Market**

For companies that do not fulfill the requirements of listing in the TPEX, the government has established a system of emerging stocks trading in TPEX in order

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<sup>411</sup> The service of the TWSE, *see* TWSE website, *available at* <http://www.tse.com.tw/en/about/company/service.php> (last visited Oct.2. 2016).

<sup>412</sup> Regarding the introduction of TPEX, *see* TPEX website: About TPEX, *available at* <http://www.tpex.org.tw/web/about/introduction/history.php?l=en-us> (last visited Oct.2. 2016).

to provide protection to investors with a legit, safe, and transparent transaction environment; in other words, a company can choose to register its stock as an emerging stock trading in TPEX as an emerging stock company instead of conducting under-the-table transactions in the black market.<sup>413</sup> The transaction of the emerging stock in the TPEX takes place way of price negotiation with stock brokers rather than using the call-auction of the automatic computing system.

## (2) Listing Process

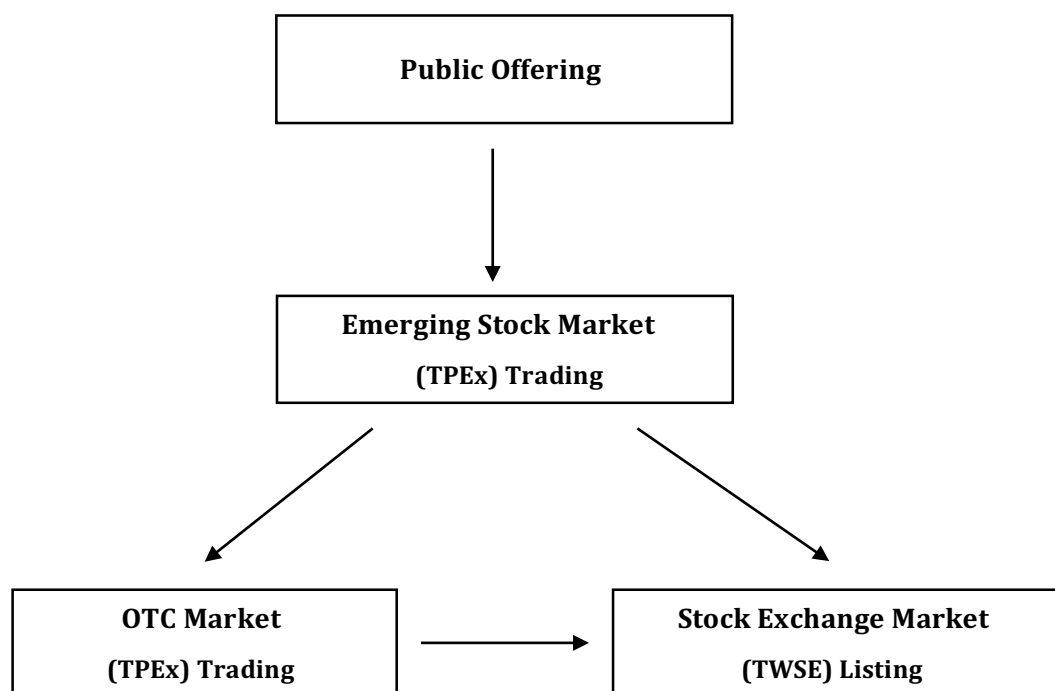
Whether a company chooses to list its stock in the TWSE or the TPEX, the company has to file for listing advisory guidance or for registration of its stock as an emerging stock trading in the TPEX at least 6 months before applying for listing.<sup>414</sup> In other words, emerging stock trading in TPEX functions as a test suite, examining whether the company is an honest and upright corporation as well as providing a chance for the company to review whether it is capable of trading its stock in the public market, and if it is appropriate to do so. See Chart 12 for a description of the order of listing stocks in stock markets in Taiwan.

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<sup>413</sup> See TPEX website: TPEX/ESM Listing (Registration) Requirements and Procedures: Pamphlet for Listing (Registration) on the TPEX/ESM, available at [http://www.tpex.org.tw/web/regular\\_emerging/apply\\_way/standard/standard.php?l=en-us#](http://www.tpex.org.tw/web/regular_emerging/apply_way/standard/standard.php?l=en-us#) (last visited Oct.2, 2016).

<sup>414</sup> CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN ZHENGQUANSHANG YINGYE CHUSUO MAIMAI YOUJIA ZHENGQUAN SHENCHA ZHUNZE(財團法人中華民國證券櫃檯買賣中心證券商營業處所買賣有價證券審查準則)[Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX] art.3, para.7(2016); an English version of Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX is available on Law Source Retrieving System of Stock Exchange and Futures Trading, available at <http://eng.selow.com.tw/LawArticle.aspx?LawID=FL007383&ModifyDate=1050519> (last visited Oct. 2, 2016); TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI YOUJIA ZHENGQUAN SHANGSHI SHENCHA ZHUNZE (臺灣證券交易所股份有限公司有價證券上市審查準則) [Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings] art. 2-1, para.1 (2016).

**Chart 12: The Order of Listing Stocks in Stock Markets in Taiwan**



Source: Gongkai Faxing Ji Shangshigui Jiben Liucheng Jieshao, Shenchu Yaodian Ji Changjian Queshi.<sup>415</sup>

### **III. Regulatory Standards for Securities Issuers**

Taiwan imposes different regulatory standards on domestic and foreign issuers. Foreign issuers are comprised of primary listing issuers and secondary

<sup>415</sup> Gongkai Faxing Ji Shangshigui Jiben Liucheng Jieshao, Shenchu Yaodian Ji Changjian Queshi (公開發行及上市櫃基本流程介紹、審查要點及常見缺失), <http://www.acc.ncku.edu.tw/files/公開發行及上市櫃基本流程介紹.pdf> (last visited Oct. 17, 2016).

listing issuers, who each receive different standards respectively. Basically, the law requires the primary listing issuer to comply with the same rules as the domestic issuer because an overseas securities regulatory authority has not supervised or regulated the primary listing issuer. By contrast, the secondary listing issuer may apply the securities governing law of its own country, since its securities are already well-regulated by overseas securities regulatory authority.

## **1. Information Disclosure Obligations Standards**

### **(1) Information Disclosure Standards Regarding Securities**

#### **Issuance**

##### **A. Immediate Information Disclosure— Prospectus Content**

The “Regulations Governing the Offering and Issuance of Securities by Foreign Issuers” requires foreign issuers to submit relevant documentation to the FSC in accordance with the securities registration process once the issuer intends to offer and issue the securities to the public.<sup>416</sup> In other words, it indicates that foreign issuers must file the relevant securities information with the FSC, and lists the items that the foreign issuer should specify in prospectus. However, the fact that the disclosed items required from the primary listing issuer and the

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<sup>416</sup> WAIGUO FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (外國發行人募集與發行有價證券處理準則)[Regulations Governing the Offering and Issuance of Securities by Foreign Issuers](2015); an English version of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers is available on Laws & Regulations Database, *available at* <http://law.moj.gov.tw/Eng/LawClass/LawContent.aspx?PCODE=G0400029> (last visited Oct. 2, 2016).

secondary listing issuer differ poses a legal issue. Additionally, the disclosure standard of the domestic issuer differs from the disclosure standard of the foreign issuer according to the “Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses”.<sup>417</sup>

Table 12 below summarizes the disclosed items that have to be provided by the domestic public issuer, the primary listing issuer, and the secondary listing issuer.

**Table 12: The Comparison of the Particulars of the Immediate Information that Must be Provided by the Domestic Public Issuer, the Primary Listing Issuer, and the Secondary Listing Issuer**

Disclosed Items (particulars)	The Domestic Public Issuer	The Primary Listing Issuer	The Secondary Listing Issuer Stock/TDRs Listing
	Chapter 2 of Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses. <sup>418</sup>	The content of the prospectus shall meet the requirements listed under Article 17 of Regulations Governing the Offering and Issuance of Securities by	In addition to the particulars required in accordance with the laws and regulations of the foreign issuer's country of registration and the country where its shares are listed, the particulars shall

<sup>417</sup> GONGSI MUJI FAXING YOUJIA ZHENGQUAN GONGKAI SHUOMINGSHU YINGXING JIZAI SHIXIANG ZHUNZE (公司募集發行有價證券公開說明書應行記載事項準則) [Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses](2015), an English version of the Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses is available on Laws & Regulations Database, available at <http://law.moj.gov.tw/Eng/LawClass/LawContent.aspx?PCODE=G0400019> (last visited Oct.2, 2016).

<sup>418</sup> GONGSI MUJI FAXING YOUJIA ZHENGQUAN GONGKAI SHUOMINGSHU YINGXING JIZAI SHIXIANG ZHUNZE (公司募集發行有價證券公開說明書應行記載事項準則) [Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses] chap. 2 (2015).

		<b>Foreign Issuers,<sup>419</sup> and also shall comply, mutatis mutandis, with the Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses.</b>	<b>be specified in the prospectus according to Article 25/34 of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers.<sup>420</sup></b>
<b>Company Summary</b>	<ol style="list-style-type: none"> <li>1. Brief company description</li> <li>2. Risks</li> <li>3. Company organization</li> <li>4. Capital and shares</li> <li>5. The description of the status of issue and private placement of "corporate bonds"</li> <li>6. The description of the status of issue and private placement of "preferred shares"</li> <li>7. The description of the status of participation in the issue and private placement of "overseas depositary receipts"</li> <li>8. The description of the status of issue and private placement of employee stock warrants</li> <li>9. The description of the status of "new restricted employee shares"</li> </ol>	Company overview, including a company introduction, the structure of the group, and the nationalities or places of registration of the directors, supervisors, managerial officers, and greater than 10 percent shareholders.	Including company and group introductions, group structure, risk matters, capital stock, and director, supervisor, managerial officer, and major shareholder information.

<sup>419</sup> WAIGUO FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (外國發行人募集與發行有價證券處理準則)[Regulations Governing the Offering and Issuance of Securities by Foreign Issuers] art. 17(2015).

<sup>420</sup> WAIGUO FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (外國發行人募集與發行有價證券處理準則)[Regulations Governing the Offering and Issuance of Securities by Foreign Issuers] art. 25/art. 34 (2015).



	10. The description of the status of mergers and acquisitions		
<b>Operation Summary</b>	<ol style="list-style-type: none"> <li>1. Operation of the company</li> <li>2. Property, plant and equipment and other real properties,</li> <li>3. Investments in other companies</li> <li>4. Important contracts</li> </ol>	Mutatis mutandis complies with the left column.	Including business scope, competitive strategy, business objectives, strategy, and plan; market, production, and sales overview; major contracts, and other matters requiring supplementary explanation.
<b>Issuance Plan and Implementation Status</b>	<ol style="list-style-type: none"> <li>1. The analysis of the previous cash capital increase, merger or acquisition, issue of new shares in connection with the acquisition of shares of another company, or plan of utilization of capital from issuance of corporate bonds</li> <li>2. The plan for the current cash capital increase, issuance of corporate bonds, issuance of employee stock warrants, or issuance of new restricted employee shares</li> <li>3. The current issue of new shares in connection with acquisition of another company's shares</li> <li>4. The current issue of new shares in connection with acquisition or merger</li> </ol>	Apply mutatis mutandis to the left column.	Including the price-setting method for the current issue and an analysis of the fund utilization plan.
<b>Financial Summary</b>	<ol style="list-style-type: none"> <li>1. Summary financial data for the most recent 5 fiscal years</li> <li>2. Financial reports</li> </ol>	The financial statements printed in the prospectus shall be the consolidated financial statements audited and attested	Including summary financial data, financial statements, and a review and analysis of the financial condition

	<p>3. Financial summary and other important matters</p> <p>4. Review and analysis of financial condition and financial performance</p>	<p>by a CPA, and the CPA audit report, for the most recent 2 fiscal years as of the time of the filing for the offering and issuance of stock. If the filing date falls more than 45 days after the end of each quarter, the consolidated financial statement for the most recent quarter reviewed by a CPA, and the CPA review report, shall additionally be submitted. If, before the printing of the prospectus, there is any most recent financial statement audited by a CPA, it shall also be disclosed therewith.</p>	<p>and operating results, for the most recent 5 fiscal years, and other important matters.</p>
<b>Special Items to be Included</b>	<p>1. "[S]pecial items to be included" shall set forth the important contents of the registration statement</p> <p>2. A company listed on the stock exchange or traded on an OTC market shall record the matters relating to the state of its implementation of corporate governance</p>	<p>Apply mutatis mutandis complies with the left column.</p>	<p>N/A</p>
<b>Other Important Items</b>	<p>N/A</p>	<p>An explanation of any material differences from the rules of the ROC in relation to the protection of shareholder equity.</p>	<p>N/A</p>

Source: Regulations Governing Information to be Published in Public Offering and Issuance Prospectuses and Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, in reference with the table on Wu<sup>421</sup> and compiled by author.

<sup>421</sup> See Wu, *supra* note 6, at 151-52.

## B. Ongoing Information Disclosure —Reporting Obligations

As previously mentioned, once the issuer becomes a public company, the issuer must fulfill certain reporting obligations, including periodic information disclosure and non-periodic information disclosure. The standards of the reporting obligations follow: “Table of Items that Foreign Issuers are Required to Publicly Disclose and File with the Financial Supervisory Commission (FSC) When Offering and Issuing Securities” on the attachment of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers.<sup>422</sup>

Regarding the periodic information disclosure, the primary listing issuer must report to the FSC with the same items and the same report manners as the domestic issuer. The secondary issuer also has to fulfill the same report duty, although it may to apply the report manners based on the law of its own country. Additionally, the secondary issuer is exempted from reporting the monthly operating status and the shareholding fluctuation of the insiders.

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<sup>422</sup> WAIGUOFAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN YINGGONGGAO JI XIANGBENHUI SHENBAO SHIXIANG YILANBIAO (外國發行人募集與發行有價證券應公告及向本會申報事項一覽表)[Table of Items that Foreign Issuers are Required to Publicly Disclose and File with the Financial Supervisory Commission (FSC) When Offering and Issuing Securities](2013), Table of Items that Foreign Issuers are Required to Publicly Disclose and File with the Financial Supervisory Commission (FSC) When Offering and Issuing Securities is on the attachment of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers, an English version is available on Laws & Regulations Database, *available at* <http://law.moj.gov.tw/Eng/LawClass/LawContent.aspx?PCODE=G0400029> (last visited Oct. 2, 2016).

Likewise, the primary listing issuer must report to the FSC with the same items and the same report manners as the domestic issuer regarding non-periodic information. The secondary issuer also has to report in the same domestic rule of report manners about any inconsistencies between the annual financial reports approved by the regular meeting of shareholders and the annual financial reports that have been announced to the public, as well as any event that has a material impact on shareholders' equity or securities prices. The rest of the non-periodic disclosure items are exempted from reporting. See Table 13 for a comparison.

**Table 13: The Comparison of the Particulars of the On-Going Information that Must be Provided by the Domestic Public Company, the Primary Listing Issuer, and the Secondary Listing Issuer**

Items		The Domestic Issuer	The Primary Listing Issuer	The Secondary Listing Issuer
<b>Periodic Information Disclosure</b>	Annual Report	✓	✓	Based on the law of the foreign issuer's country
	Annual Financial Report	✓	✓	Based on the law of the foreign issuer's country
	Quarterly Financial Report	✓	✓	Based on the law of the foreign issuer's country
	Monthly Operating Status	✓	✓	Not Required
	Shareholding Fluctuation of the insiders	✓	✓	Not Required
<b>Non-Periodic Information Disclosure</b>	The annual financial reports approved by the regular meeting of shareholders if such reports are inconsistent with the annual financial reports which have been announced to the public and filed with the FSC.	✓	✓	✓
	Any event which has a material impact on	✓	✓	✓

	shareholders' equity or securities prices.			
	Major financial or operational actions of public companies such as acquisition or disposal of assets	✓	✓	Not Required
	Engaging in derivatives trading, extension of monetary loans to others	✓	✓	Not Required
	Endorsements or guarantees for others disclosure of financial projections	✓	✓	Not Required

Source: Table of Items that Foreign Issuers are Required to Publicly Disclose and File with the Financial Supervisory Commission (FSC) When Offering and Issuing Securities, and compiled by author.

### C. Accounting Principle Application

The financial statement standard differs between the primary listing issuer and the secondary listing issuer because the applications of the financial report of Article 14 of the Securities and Exchange Act differ between each issuer. According to Article 165-1 and Article 165-2, Article 14 applies to the primary listing issuer in its entirety, whereas the secondary listing issuer must only follow the rules laid out in Paragraphs 1 and 3, and may ignore Paragraph 2 of the article. Paragraph 2 of Article 14 states:

Regulations governing the preparation of financial reports with respect to the content, scope, procedures, preparation, and other matters to be complied with for the financial reports referred to in the preceding paragraph shall be prescribed by the Competent Authority, and Chapters IV, VI, and VII of the Business Entity Accounting Act shall not apply to those financial reports.<sup>423</sup>

<sup>423</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 14, para. 2 (2016).

Thus, the financial report accounting standard prescribed by the FSC applies to the primary listing issuer. The FSC is currently promoting enterprises to adopt International Financial Reporting Standards (“IFRS”) as they are well-accepted international standards. According to the explanation of the amendment of Article 14, in 2013 the FSC was planning to require the public companies to adopt IFRS in order to improve the comparability of the financial reports between domestic and foreign enterprises, as well as increasing the international competitiveness of the Taiwanese capital markets:

[T]his way, domestic companies do not have to reproduce a new financial report when conducting overseas fund raising. Further, it facilitates foreign company to comply with the IFRS without additional unnecessary accounting cost. Since the Business Entity Accounting Act does not adopt IFRS, Paragraph 2 of Article 14 authorizes the FSC to prescribe the international standard of accounting, namely IFRS, without the application of the Business Entity Accounting Act.<sup>424</sup>

Pursuant to the mutatis mutandis application to Article 14, it seems that the primary listing issuer only has to comply with the IFRS. However, in 2014 the FSC enacted the regulation of “Financial-Supervisory-Securities-Auditing”, allowing the primary listing issuer to choose between adopting IFRS or U.S. GAAP as recognized by the U.S. Financial Accounting Standards Board. As the regulation states:

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<sup>424</sup> The dissertation explicitly expresses the intent of the 2012 amendment to Article 14 of the Securities and Exchange Act. For the original wording, *see* the legal research system under the Taiwan Legislative Yuan, *supra* note 354.

In the preparation of financial reports by the foreign companies defined in Article 165-1 of the Securities and Exchange Act, the provisions set out below shall be applied, and in addition, the Regulations Governing the Preparation of Financial Reports by Securities Issuers adopted pursuant to Article 14 of the Securities and Exchange Act shall also be applied mutatis mutandis:

- (1) A foreign company may choose to adopt one of the following sets of accounting principles for the preparation of their financial reports, and shall state in the notes to the report which accounting principle was applied:
  - i. The International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), and Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC), as endorsed by the FSC, as referred to in Article 3 of the Regulations Governing the Preparation of Financial Reports by Securities Issuers.
  - ii. The generally accepted accounting principles recognized by the Financial Accounting Standards Board (FASB).
  - iii. The IFRS, IAS, IFRIC and SIC issued by the International Accounting Standards Board (IASB).<sup>425</sup>

On the other hand, since the secondary listing issuer does not have to follow paragraph 2 of Article 14, it also does not necessarily have to follow the IFRS

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<sup>425</sup> YOUGUAN GUIFAN WAIGUO GONGSI CAIWU BOGAO BIANZHI ZHI LING(有關規範外國公司財務報告編製之令) [Financial-Supervisory-Securities-Auditing](2014), an English version of Financial-Supervisory-Securities-Auditing is available on Laws and Regulations Retrieving System of the FSC, available at <http://law.fsc.gov.tw/law/EngLawContent.aspx?Type=E&id=1699> (lasted visited Oct. 3, 2016).

standard. The secondary listing issuer must follow the financial report standard application in order to fulfill the accounting standard of its own country according to the intention of the amendment of Article 165-2. Therefore, the secondary listing issuer may adopt either IFRS or the GAAP of its home countries, according to the regulation of the jurisdiction where the company sets up.

#### **D. The Periodic Disclosure and Financial Report Standard**

Article 36 of the Securities and Exchange Act covers regulations in the Periodic Disclosure and Financial Report, amended to adopt the IFRS standard.<sup>426</sup> The IFRS follows consolidated financial statements and requires interim consolidated statements. Thus, in accordance with IFRS requirements, Article 36 requires an issuer to make a public announcement and register with the FSC within 45 days after the end of the first, second, and third quarters of each fiscal year, regarding financial reports duly reviewed by a certified public accountant and reported to the board of directors.

According to Article 165-1 and Article 165-2, both the primary and the secondary listing issuer must follow the Article 36 rules regarding the regulation of the IFRS financial standard for the periodic report. Since the secondary listing issuer may follow the financial standard of its own country, it is questionable whether Article 165-2 requires the secondary listing issuer to apply to the IFRS financial standard for the periodic report. The regulation under the application of

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<sup>426</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 36 (2016).



Article 165-2 to Article 36 requiring the secondary issuer to follow the relevant requirements of consolidated financial statement is inconsistent with the original legislation that allows the secondary issuer to adopt the standard of its own country or the previous listed jurisdiction. The application also contradicts the regulation of choosing the financial standard in Article 14, which does not compulsorily require the secondary issuer to follow IFRS.

## **2. Corporate Governance Member Installment and Internal Control Requirements**

Regarding the corporate governance requirements, the primary listing issuer must follow the same rules as the domestic issuer, such as the installment of independent directors and the audit committee pursuant to Article 165-1 as it applies *mutatis mutandis* to Article 14-1 to 14-5.<sup>427</sup> By contrast, such requirements are not imposed on the secondary issuer under Article 165-2. See Table 14 for the comparison.

### **Table 14: The Comparison of the Corporate Governance Member Installment and Internal Control Requirements among the Domestic Issuer, the Primary Listing Issuer and the Secondary Listing Issuer**

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<sup>427</sup> ZHENGQUAN JIAOYI FA (證券交易法)[Securities and Exchange Act] art. 14-1, 14-2, 14-3, 14-4, 14-5 (2016).

<b>Items</b>	<b>The Domestic Issuer</b>	<b>The Primary Listing Issuer</b>	<b>The Secondary Listing Issuer</b>
<b>Establishing Financial and Operational Internal Control Systems and Filing an Internal Control System Statement with the FSC</b>	✓	✓	Not Required
<b>Appointing Independent Directors</b>	✓	✓	Not Required
<b>Power of Independent Director</b>	✓	✓	Not Required
<b>Establishing either an Audit Committee or a Supervisor</b>	✓	✓	Not Required
<b>Power of Audit Committee</b>	✓	✓	Not Required

Source: Securities and Exchange Act, and compiled by the Author.

### **3. Listing Standards on Taiwan Exchanges**

When issuers list securities in the stock exchanges or over-the-counter market, issuers must comply with certain rules; i.e., the scale of the company must reach a certain scope and the insiders must fulfill certain requirements. There are different standards of listing in the TWSE and the TPEX. Generally, the listing standards in the TWSE are more demanding than the standards in the TPEX because the TWSE is the stock exchange for companies with such large scale that their stocks issued deserved much higher liquidity. However, it is worth noting the comparison of the listing standards among the domestic issuer, the primary listing issuer and the secondary issuer.

#### **(1) Equity Securities—Stocks and TDRs**

## A. Pre-Listing Requirements

### (A) Pre-Listing Standards

The primary listing issuer must comply with the same pre-listing requirements as the domestic issuer.<sup>428</sup> A primary issuer who intends to list in the TWSE or TPEX must first follow listing advisory guidance from the lead securities underwriter, or apply for registration of its stock as emerging stock and trade in the TPEX for no fewer than 6 months, before the TWSE or TPEX will process an initial application.<sup>429</sup> By contrast, the secondary listing issuer who intends to list in the TWSE or TPEX has to issue its registered shares in accordance with the law of its country of registration. Additionally, the secondary listing issuer must have already listed and traded its shares on the main board of one of the overseas securities markets approved by the FSC before it can list the stocks under the listing application.<sup>430</sup> See Table 15 for the comparison of pre-listing (trading) standards, and Table 16 for the summary comparison.

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<sup>428</sup> *Supra* note 414.

<sup>429</sup> CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN WAIGUO YOUJIA ZHENGQUAN GUITAI MAIMAI SHENCHA ZHUNZE(財團法人中華民國證券櫃檯買賣中心外國有價證券櫃檯買賣審查準則)[Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX] art.4, para. 1, sub. 12 (2016); an English version of Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX is available on Law Source Retrieving System of Stock Exchange and Futures Trading, *available at* <http://eng.selaw.com.tw/LawArticle.aspx?LawID=FL007424&ModifyDate=1050519> (last visited Oct. 3, 2016); TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI YOUJIA ZHENGQUAN SHANGSHI SHENCHA ZHUNZE (臺灣證券交易所股份有限公司有價證券上市審查準則) [Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings] art. 2-1, para.25 (2016).

<sup>430</sup> TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI YOUJIA ZHENGQUAN SHANGSHI SHENCHA ZHUNZE BUCHONG GUIDING (臺灣證券交易所股份有限公司有價證券上市審查準則補充規定)[Supplementary Provisions to the Taiwan Stock Exchange Corporation Rules for Review of Securities Listings] art. 23 (2017); an English version of Supplementary Provisions to

**Table 15: The Comparison of the Pre-Listing (Trading) Standards among the Domestic Issuer, the Primary Listing Issuer and the Secondary Listing Issuer**

Types of Standards		The Domestic Issuer	The Primary Listing Issuer	The Secondary Listing Issuer
Period of Operation	TWSE	It has been incorporated and registered under the Company Act for at least 3 years at the time of the application for listing; provided, this restriction shall not apply to public (state-owned) enterprises or to privatized public enterprises.	The applicant company or any of its controlled companies shall have an operational track record of 3 years or longer.	Not Required
	TPEX	It shall have been incorporated and registered under the Company Act for no fewer than 2 full fiscal years.	It has been incorporated and registered in accordance with foreign law for at least 2 full accounting years	Not Required
Period Under Listing Advisory Guidance		Has applied for registration of its stock as emerging stock and had it traded on the TPEX, for no fewer than 6 months	Under listing advisory guidance by the lead securities underwriter for not less than 6 months, or	Not Required

the Taiwan Stock Exchange Corporation Rules for Review of Securities Listings is available on Rules & Regulations Directory of the TWSE, available at <http://twse-regulation.twse.com.tw/ENG/EN/law/DAT0201.aspx?FLCODE=FL007330> (last visited Oct. 3, 2016); CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN WAIGUO YOUJIA ZHENGQUAN GUITAI MAIMAI SHENCHA ZHUNZE (財團法人中華民國證券櫃檯買賣中心外國有價證券櫃檯買賣審查準則)[Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX] art. 24, para. 1, sub. 2 (2016); CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN SHENCHA WAIGUO YOUJIA ZHENGQUAN GUITAI MAIMAI ZUOYE CHENGXU (財團法人中華民國證券櫃檯買賣中心審查外國有價證券櫃檯買賣作業程序) [Taipei Exchange Procedures for Review of TPEX Trading of Foreign Securities] attachment 25-1 (2016); an English of Taipei Exchange Procedures for Review of TPEX Trading of Foreign Securities is available on Law Source Retrieving System of Stock Exchange and Futures Trading, available at <http://eng.selaw.com.tw/LawArticle.aspx?LawID=FL007425&ModifyDate=1050506> (last visited Oct. 3, 2016).

		has applied for registration of its stock as emerging stock and had it traded on the TPEX, for no fewer than 6 months	
<b>The Main Board of the Overseas Securities Markets Approved by the FSC</b>	Not Required	Not Required	NYSE Euronext Group NASDAQ OMX Group London Stock Exchange Group Deutsche Borse AG Frankfurter Wertpapierbörse (FWB) TMX Group Inc. Toronto Stock Exchange Australian Securities Exchange Tokyo Stock Exchange Osaka Securities Exchange Singapore Exchange Bursa Malaysia Stock Exchange of Thailand Johannesburg Stock Exchange Hong Kong Exchanges and Clearing Ltd. Korea Exchange Other overseas securities markets as approved by the competent authority.

Source: Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, Supplementary Provisions to the Taiwan Stock Exchange Corporation Rules for Review of Securities Listings, Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX, Taipei Exchange Procedures for Review of TPEX Trading of Foreign Securities, and compiled by the Author.

**Table 16: The Summary Comparison of the Pre-Listing (Trading) Standards among the Domestic Public Company, the Primary Listing Issuer and the Secondary Listing Issuer**

Type of Standard	Domestic Issuer	Primary Listing Issuer	Secondary Listing Issuer
Period of Operation	✓	✓	Not Required
Period Under Listing Advisory Guidance	✓	✓	Not Required
The Main Board of the Overseas Securities Markets Approved by the FSC	Not Required	Not Required	✓

Source: Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, Supplementary Provisions to the Taiwan Stock Exchange Corporation Rules for Review of Securities Listings, Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX, Taipei Exchange Procedures for Review of TPEX Trading of Foreign Securities, and compiled by the author.

### (A) Standards for the Emerging Stocks Trading on the TPEX

“Taipei Exchange Rules Governing the Review of Emerging Stocks for Trading on the TPEX” covers the rules and regulations regarding the emerging stocks trading on the TPEX.<sup>431</sup>

An issuer who applies for registration of its stock as emerging stock and trades that stock on the TPEX does not need to fulfill the requirements regarding the capability of the company such as profitability, period of operation, or the

<sup>431</sup> CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN ZHENGQUANSHANG YINGYE CHUSUO MAIMAI XINGGUI GUPIAO SHENCHA ZHUNZE(財團法人中華民國證券櫃檯買賣中心證券商營業處所買賣興櫃股票審查準則)[Taipei Exchange Rules Governing the Review of Emerging Stocks for Trading on the TPEX](2016); an English version of Taipei Exchange Rules Governing the Review of Emerging Stocks for Trading on the TPEX is available on Law Source Retrieving System of Stock Exchange and Futures Trading, available at <http://eng.selow.com.tw/LawArticle.aspx?LawID=FL007442&ModifyDate=1050219> (last visited Oct. 4, 2016).

dispersion of share ownership for listing in the TWSE or TPEX. On the other hand, the issuer must comply with only some fundamental requirements, because the issuer only establishes the platform of emerging stock trading on the TPEX in order to protect investors via a reliable channel to purchase non-listing stocks. See Table 17 for registration requirements of the foreign issuer trading its shares as emerging stocks:<sup>432</sup>

**Table 17: Standards for Emerging Stocks Trading on the TPEX**

<b>Not listed for trading on any overseas securities market</b>	Its issued registered stock is not listed for trading on any overseas securities market, and it has not applied with the TPEX or the TWSE for a TPEX primary listing or TWSE primary listing of its stock.
<b>Recommendations</b>	Received recommendations by two or more advisory recommending securities firms.
<b>Advisory Contract</b>	It has signed an advisory contract with securities firms.
<b>Professional Shareholder Services Agent</b>	It shall engage a professional shareholder services agent to handle shareholder services.
<b>Litigious and Non-Litigious Agent</b>	It has appointed at least one litigious and non-litigious agent who has a domicile or residence within Taiwan.
<b>Form of Stocks</b>	Any stocks and bonds offered and issued or privately placed shall be issued in scripless form; provided, this restriction shall not apply if the laws or regulations of the country of its registration provide otherwise.
<b>Remuneration Committee</b>	It has established a remuneration committee.
<b>Comply in the Following</b>	If any important matters in connection with protection of shareholder equity conflict with mandatory provisions of laws or regulations of the issuer's country of registration, the issuer shall enhance the disclosure of the material discrepancies in its prospectus.

Source: Taipei Exchange Rules Governing the Review of Emerging Stocks for Trading on the TPEX, and compiled by the author.

<sup>432</sup> CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN ZHENGQUANSHANG YINGYE CHUSUO MAIMAI XINGGUI GUPIAO SHENCHA ZHUNZE(財團法人中華民國證券櫃檯買賣中心證券商營業處所買賣興櫃股票審查準則)[Taipei Exchange Rules Governing the Review of Emerging Stocks for Trading on the TPEX] art. 7 (2016)

## **B. Quantitative Standards**

The requirements for quantitative standards are the most confusing part. If we followed the previous idea of the legislative purpose as mentioned before, the standard for the primary listing issuer should have been the same as the one for the domestic issuer. However, there are inconsistencies existing in both TWSE and TPEx quantitative standards.

### **(A) TWSE Quantitative Standards**

The Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings regulates TWSE quantitative standards.<sup>433</sup> Regarding the item of company scale, the standards for the domestic issuer and the secondary issuer seem to be the same at the first glance because they both require the same paid-in capital of NT\$600 million or more at the time of application. However, a conditional requirement states that the number of shares of its publicly offered and issued common stock must exceed 30 million shares for the domestic issuer, with an alternative requirement of market capitalization of \$1.6 billion for the primary listing issuer. In other words, the standard for the primary listing issuer

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<sup>433</sup> The comparison of listing standards, *see* TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI YOUJIA ZHENGQUAN SHANGSHI SHENCHA ZHUNZE (臺灣證券交易所股份有限公司有價證券上市審查準則) [Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings] art. 4 (domestic issuer standard), art. 26 (secondary listing standard for TDR), art. 27 (secondary listing standard for stock), art. 28-1 (primary listing standard) (2016).



is not the same as the standard of the domestic issuer, and the standard of the secondary listing issuer is higher than the standard of the secondary listing issuer.

In addition, we find out that the profitability criteria of the domestic issuer, the primary listing issuer, and the secondary listing issuer are different. Compared with the domestic issuer, the criteria of the primary listing issuer appear to be more demanding because they require the primary issuer to reach a certain price amount, whereas the criteria of the domestic company are calculated by the percentage index of accounting calculation. However, what is confusing is the criteria of the secondary listing issuer—it is higher than the criteria of the primary listing issuer because the profitability criteria of the secondary listing issuer combine the price amount standard with the percentage index of accounting calculation, which is even more complicated, to value the profitability. One more piece of evidence shows that the standard on the secondary listing issuer is stricter. The amount required on the primary listing issuer is calculated by the cumulative income of NT\$250 million, while the amount required for the secondary listing issuer is calculated by the single annual income of NT\$250. Therefore, it turns out that the standard on the secondary listing issuer is higher than the standard on the primary listing issuer, and the domestic issuer is the most relaxed one of all three. This result totally contradicts the original purpose of this rule. See the comparison of the TWSE quantitative standards in Table 18 and Table 19.

**Table 18: Comparison of Requirements among the Domestic Issuer, Primary Listing Issuer, and Secondary Listing Issuer under the TWSE Quantitative Standards**

<b>Items</b>	<b>Domestic Issuer Listing in TWSE</b>	<b>Primary Listing in TWSE</b>	<b>Secondary Listing in TWSE</b>
<b>Dispersion of Share Ownership</b>	The number of registered shareholders is 1,000 or more. Excluding company insiders and any juristic persons in which such insiders hold more than 50 percent of the shares, the number of registered shareholders is at least 500, and the total number of shares they hold is 20 percent or greater of the total issued shares, or at least 10 million.	Its number of shareholders on record is 1,000 or more, and the number of shareholders other than insiders of the foreign issuer and juristic persons of which such insiders own over 50 percent of the shareholding is no fewer than 500 and their total shareholdings constitute 20 percent or more of the total issued shares or not fewer than 10 million shares.	At the time of the proposed listing, the number of registered shareholders (of TDRs) in Taiwan is not fewer than 1,000 persons, and the total number of shares held by shareholders other than insiders of the foreign issuer and juristic persons of which such insiders own over 50 percent of the shareholding is 20 percent or more of the total number of issued shares or is 10 million shares or more.
<b>Pricing Standard</b>	Not Required	Not Required	Required
<b>Company's Market Value (Company Scale)—Net Worth</b>	At the time it applies for listing, its paid-in capital is NT\$600 million or more and the number of shares of its publicly offered and issued common stock is 30 million shares or more.	At the time of application for listing, paid-in capital or net worth is NT\$600 million or higher, or market capitalization is NT\$1.6 billion or higher.	The net worth stated on the financial report audited and attested by a CPA for the most recent period shall be the equivalent of NT\$600 million or more.
<b>Profitability (Financial Standard)</b>	The net income before tax in its financial reports meets either of the following criteria, and it does not have any accumulated deficit in the final accounting for the most recent fiscal year: (1) The net income before tax for the most recent 2 fiscal years represents 6	Its cumulative net income before tax for the most recent 3 fiscal years is NT\$250 million or higher, and its net income before tax for the most recent fiscal year is NT\$120 million or higher.	It does not have accumulative loss for the most recent one fiscal year and meets one of the following criteria: (1) The net income before tax for the most recent one year represents not less than 6 percent of the net worth as shown in its final accounts.

	<p>percent or greater of the share capital stated on the financial report for the annual final accounts.</p> <p>(2) The net income before tax for the most recent 2 fiscal years represent 6 percent or greater of the amount of paid-in capital in its final accounts and the profitability for the most recent fiscal year is greater than that for the immediately preceding fiscal year; or</p> <p>(3) The net income before tax for the most recent 5 years represents 3 percent or greater of the share capital stated on the financial report for the annual final accounts.</p>		<p>(2) The ratio of net income before tax to net worth in the final accounting for each of the past 2 fiscal years is 3 percent or higher, or the average is 3 percent or higher, and the profitability in the most recent fiscal year is better year-on-year than in the preceding year.</p> <p>(3) The net income before tax for the most recent 2 years shall be NT\$250 million or more.</p>
<b>Number of shares to be listed</b>	Not required	N/A	20 million shares (TDR) or more, or the market price of the shares to be listed (TDR) must be NT\$300 million or more; the number of shares (TDR) may not exceed 50 percent of the total number of shares issued by the foreign issuer.

Source: Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, and compiled by the author.

**Table 19: Summary Comparison among the Domestic Issuer, Primary Listing Issuer, and Secondary Listing Issuer under the TWSE Quantitative Standards**

Type of Standard	Domestic Issuer	Primary Listing Issuer	Secondary Listing Issuer
Distribution Standard	✓	✓	✓
Pricing Standard	Not Required	Not Required	Not Required
Company's Market Value (Company Scale)—Net Worth	High	Low	Medium
Profitability (Financial Standard)	Low	Medium	High
Number of Shares to be listed	Not Required	Not Required	✓

Source: Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, and compiled by the author.

## **(B) TPEX Quantitative Standards**

The Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX regulates the rules regarding the domestic issuer listing in the TPEX;<sup>434</sup> by contrast, rules regarding the foreign issuer listing in the TPEX are

<sup>434</sup> CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN ZHENGQUANSHANG YINGYE CHUSUO MAIMAI YOUJIA ZHENGQUAN SHENCHA ZHUNZE(財團法人中華民國證券櫃檯買賣中心證券商營業處所買賣有價證券審查準則)[Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX] art. 3 (2016).

regulated in the Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX.<sup>435</sup>

The standards for listing in the TPEX are less demanding than the standards for listing in the TWSE because the TPEX is an over-the-counter market. Ideally, the standard for the primary listing issuer should be the same as the one of the domestic company. However, once again, the same issue arises: the standards for the domestic issuer and the primary issuer are different. Additionally, the standard for the secondary issuer turns out to be the most rigorous.

Focusing on the standards of the company scale, the paid-in capital requirement for the domestic issuer is no less than NT\$50 million, while the requirement for the primary listing issuer is at least NT\$100 million of the total equity attributable to owners. What is more, the requirement for the secondary listing issuer is at least NT\$200 million of the total equity attributable to owners. One may question why the same standard does not apply to both the domestic and the primary listing issuer. It is confusing to demand the secondary issuer with the highest amount of company scale standard.

As for the financial requirements, it turns out that there is no distinction among the three issuers.

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<sup>435</sup> CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN WAIGUO YOUJIA ZHENGQUAN GUITAI MAIMAI SHENCHA ZHUNZE (財團法人中華民國證券櫃檯買賣中心外國有價證券櫃檯買賣審查準則)[Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX] art. 4 (primary trading standard), art. 24 (secondary trading standard for stock), art. 27 (secondary trading standard for TDR) (2016).

See the comparison of the TPEX quantitative standards in Table 20 and Table 21.

**Table 20: Comparison of Requirements among the Domestic Issuer, Primary Listing Issuer, and Secondary Listing Issuer under the TPEX Quantitative Standards**

<b>Items</b>	<b>Domestic Issuer Listing in the TPEX</b>	<b>Primary Listing Issuer in the TPEX</b>	<b>Secondary Listing Issuer in the TPEX</b>
<b>Dispersion of Share Ownership</b>	Its number of registered shareholders, excluding company insiders and any juristic person in which such insiders hold more than 50 percent of the shares, shall not be fewer than 300; the total amount of the combined shareholdings of such registered shareholders shall constitute 20 percent or more of the total issued shares, or more than 10 million shares.	The company, excluding company insiders and any juristic persons in which such insiders hold more than 50 percent of the shares, must have at least 300 registered shareholders, and the combined shareholdings those shareholders must account for 20 percent or more of the total issued shares, or more than 10 million shares, of the applicant company.	The company, excluding company insiders and any juristic persons in which such insiders hold more than 50 percent of the shares, must have at least 300 registered shareholders (of TDRs) residing within Taiwan, and the combined shareholdings those shareholders must account for 20 percent or more of the total issued units, or more than 10 million units, of the applicant company.
<b>Pricing Standard</b>	Not Required	Not Required	Not Required
<b>Company's Market Value (Company Scale)—Net Worth</b>	Its paid-in capital shall be not less than NT\$50 million.	Its total equity attributable to owners of the parent company as audited and attested by a CPA for the most recent period must be equivalent to at least NT\$100 million.	Its total equity attributable to owners of the parent company as audited and attested by a CPA for the most recent period must be equivalent to at least NT\$200 million.
<b>Profitability (Financial Standard)</b>	Net income before tax, excluding net income (or loss) from non-controlling interests for the most recent fiscal year, may not be less than	Same as the standard on the domestic issuer.	Same as the standard on the domestic issuer.

	<p>the equivalent of NT\$4 million, and its ratio to the amount of equity attributable to owners of the parent company shall meet one of the following conditions:</p> <p>(1) Having reached 4 percent or higher in the most recent fiscal year, with no accumulated deficit after final accounting for the most recent fiscal year.</p> <p>(2) Having reached 3 percent or higher in both of the most recent 2 fiscal years.</p> <p>(3) The average of the most recent 2 fiscal years is 3 percent or higher, and profitability in the most recent fiscal year is higher than that of the preceding fiscal year.</p>		
<b>Number of Shares (TDRs) to be Traded</b>	N/A	N/A	10 million shares (TDRs) or more, or the market price of the shares to be listed (TDRs) is NT\$100 million or more; the number of shares (TDRs) may not exceed 50 percent of the total number of shares issued by the foreign issuer.

Source: Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX and Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX, and compiled by author.

**Table 21: Summary Comparison among the Domestic Issuer, Primary Listing Issuer, and Secondary Listing Issuer under the TPEX Quantitative Standards**

Type of Standard	Domestic Issuer	Primary Listing Issuer	Secondary Listing Issuer
Distribution Standard	✓	✓	✓
Pricing Standard	Not Required	Not Required	Not Required
Company's Market Value (Company Scale)	Low	Medium	High
Profitability (Financial Standard)	✓	✓	✓
Number of Shares to be listed	Not Required	Not Required	✓

Source: Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX and Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX, and compiled by the author.

### C. Corporate Governance Standards

Regarding corporate governance standards, the primary listing issuer has to follow the same requirements as the domestic issuer, including the installment of independent directors as well as supervisors and audit committee. The secondary listing issuer may comply with the corporate governance standards of its own countries.<sup>436</sup> See the comparison in Table 22 and Table 23.

<sup>436</sup> The standards of corporate governance for listing in TWSE, see TAIWAN ZHENGQUAN JIAOYISUO GUFEN YOUXIAN GONGSI YOUJIA ZHENGQUAN SHANGSHI SHENCHA ZHUNZE (臺灣證券交易所股份有限公司有價證券上市審查準則) [Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings] art. 9 (domestic issuer standard), art. 28-4 (primary listing standard) (2016).

The standards of corporate governance for primary trading in TPEX, see CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN WAIGUO YOUJIA ZHENGQUAN GUITAI MAIMAI SHENCHA ZHUNZE (財團法人中華民國證券櫃檯買賣中心外國有價證券櫃檯買



**Table 22: Comparison of Corporate Governance Standards among the Domestic Issuer, Primary Listing Issuer, and Secondary Listing Issuer.**

Type of Standard	Domestic Issuer	Primary Listing Issuer	Secondary Listing Issuer
<b>Independent Directors</b>	May not have fewer than 5 directors on its board, and shall appoint independent directors numbering not fewer than 2 persons and not fewer than one-fifth of the number of directors (at least one of the independent directors shall be domiciled in Taiwan.)	Same as the standard on the domestic issuer.	Not Required
<b>Supervisors and Audit Committee</b>	Shall install either: an audit committee (all the independent directors; it may not have fewer than 3 members), or supervisors (it may not have fewer than 3 members)	Same as the standard on the domestic issuer.	Not Required

Source: Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX and Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX, and compiled by author.

**Table 23: Summary Comparison of Corporate Governance Standards among the Domestic Issuer, Primary Listing Issuer and Secondary Listing Issuer**

賣審查準則)[Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX] art. 14 (primary trading standard) (2016). There is no specific rule of corporate governance standard for the domestic issuer trading in TPEX pursuant to CAITUAN FAREN ZHONGHUA MINGUO ZHENGQUAN GUITAI MAIMAI ZHONGXIN ZHENGQUANSHANG YINGYE CHUSUO MAIMAI YOUJIA ZHENGQUAN SHENCHA ZHUNZE(財團法人中華民國證券櫃檯買賣中心證券商營業處所買賣有價證券審查準則)[Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX] (2016). However, domestic issuer trading in TPEX has to follow the corporate governance standard pursuant to Article 14-1 to 14-5 of Securities and Exchange Act.

Type of Standard	Domestic Issuer	Primary Listing Issuer	Secondary Listing Issuer
Independent Directors	✓	✓	Not Required
Supervisors and Audit Committee	✓	✓	Not Required

Source: Taiwan Stock Exchange Corporation Rules Governing Review of Securities Listings, Taipei Exchange Rules Governing the Review of Foreign Securities for Trading on the TPEX and Taipei Exchange Rules Governing the Review of Securities for Trading on the TPEX, and compiled by the author.

## **(2) Debt Securities—Corporate Bonds**

Basically, the requirements of bond issuance for the foreign issuer state that the issuer must list its stock in the TWSE or the TPEX for a certain period of time before issuing corporate bonds. In other words, exchange markets will approve the issuer for issuance after it has reached the previously mentioned listing standards of securities issuance in the exchanges, as well as listing the securities for a certain period of time. According to Subparagraph 1 of Paragraph 1 of Article 45 of Regulations Governing the Offering and Issuance of Securities by Foreign Issuers:

1. The issuer is a primary exchange (or OTC) listed company that has been domestically listed, or whose securities have been trading on the OTC market, for a combined total of a full 3 years, or is a secondary exchange (or OTC) listed company whose stocks, or securities representing its stocks, have been listed and traded on one of the overseas securities markets approved by the competent

authority for a full 3 years. However, in either of the following circumstances, this restriction shall not apply:

- A. An issuer filing to issue straight corporate bonds is a company controlled by another company, the bonds are fully guaranteed by the controlling company, and the stock of the controlling company has been listed and traded on one of the overseas securities markets approved by the competent authority for a full 3 years.
- B. The issuer is an overseas financial institution that has been approved by the FSC to establish a domestic branch in the ROC (Taiwan), and the stock of the financial institution's parent holding company has been listed and traded on one of the overseas securities markets approved by the competent authority for a full 3 years.<sup>437</sup>

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<sup>437</sup> WAIGUO FAXINGREN MUJI YU FAXING YOUJIA ZHENGQUAN CHULI ZHUNZE (外國發行人募集與發行有價證券處理準則) [Regulations Governing the Offering and Issuance of Securities by Foreign Issuers] art. 45, para.1, sub. 1 (2015).

## **Chapter 5: A Comparison of Regulations, the Disadvantages of the Taiwanese Regulations, and Suggestions for Future**

### **Taiwanese Regulatory Reformation**

#### **I. A Comparison of the Regulations between the U.S. and Taiwan**

##### **1. Analysis of U.S. Regulations**

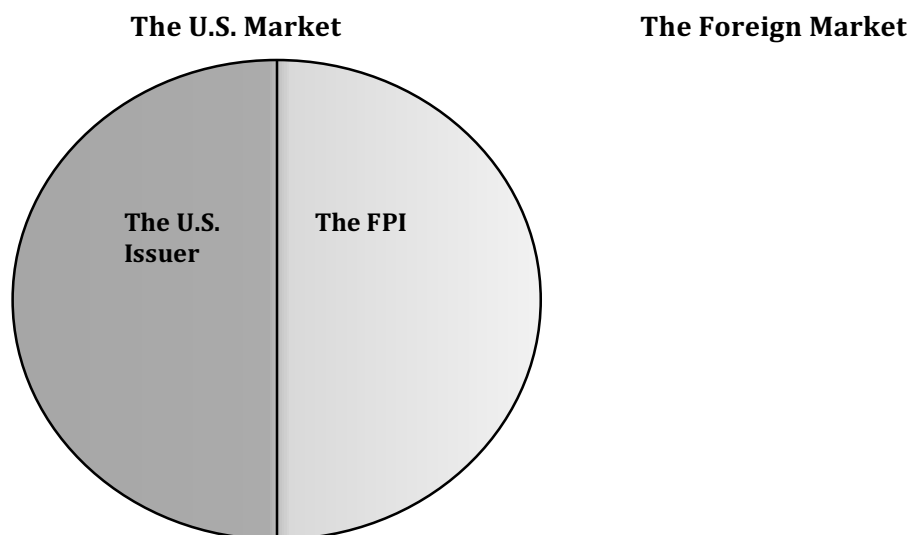
###### **(1) Characteristics of Current U.S. Regulations**

###### **A. Strict Definition of the U.S. market**

Current U.S. regulatory philosophy adopts the perspective of U.S. investor-protection as regulatory direction. The legislators properly define the U.S. market and non-U.S. market and impose issuers with legal obligations—mainly information disclosure obligations when issuers intend to issue securities in the U.S. market. An issuer has to comply with the U.S. regulatory requirements whether it is a domestic or a foreign issuer, but the regulator provide special treatments to the foreign issuer with a lenient standard when it comes to conducting securities transactions in the U.S. market.

Chart 13 illustrates the structure of the current U.S. regulation.

**Chart 13: The Structure of the Current U.S. Regulation**



Source: Compiled by the Author

In the U.S. market, the issuance of securities influences the interests of domestic investors. The U.S. market determines whether the securities transaction location is in the U.S. or investors conducting securities transactions are U.S. residents.<sup>438</sup>

In the U.S. market, the issuer's most substantial legal obligation for securities transactions is that of information disclosure. Due to information asymmetry, securities issuance affects investors' investment decision. According to the efficient-market hypothesis, clear information is the foundation of making proper investment decisions;<sup>439</sup> therefore, the issuer is obligated to offer an information

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<sup>438</sup> Fox, *supra* note 40.

<sup>439</sup> See Coffee, *supra* note 111 at 722-23.

disclosure in the securities issuance. The issuance of securities in the U.S. market saddles the issuer with multiple legal obligations; specifically, both the location of the issuer's transaction and the investor's residency determine the U.S. market that triggers the issuer's obligations. First, securities transactions, including offering and selling in the primary market as well as listing and trading on securities exchanges in the U.S., contribute to the issuer's immediate and ongoing obligations of information disclosure. Additionally, the reach of a certain number of investors results in the issuer's information disclosure in the secondary market.

In the U.S. market, securities without the disclosure of information are restricted securities. Restricted securities cannot be freely sold and traded in the market. Restricted securities turn into non-restricted securities only after an issuer releases a full disclosure of information. However, under the premise of not affecting the interests of public investors, U.S. law creates some special channels in the trading market that enables the issuer to sell restricted securities in order to increase the efficiency of fund raising. The initiation of special channels derives from the mechanism of private placement, where the issuer can sell restricted securities to certain sophisticated purchasers without disclosing information to the public, because it will not affect the interests of public investors.

Exempting an issuer from information disclosure by allowing them to conduct private placement initiates a specific channel of trading market that facilitates fundraising in a more liquid and efficient way. The resale exemption keeps the channel open and unblocked so that issuers can continuously transfer restricted securities. The reinforcement of the resale exemption accelerates the

issuer to use the special channel of trading market without interfering with the public investors. Hence, the regulator and the court have made several rules to strengthen the accessibility of resale exemption. A series of rules including Rule 144, Section (a) 4(1 1/2), Rule 144A, and Regulation S were created to facilitate the special channels of trading market.<sup>440</sup>

The regulator created Rule 144A and Regulation S to make fundraising more convenient for foreign issuers. The foreign issuer may combine the use of private placement with Rule 144A and Regulation S to create a smooth trading market with high liquidity. Such a specific trading market is not considered to be the same as the domestic market because the trading market built on Rule 144A and Regulation S does not include a “direct sell” options to U.S. investors, and the securities are forbidden from “flowing back” to the U.S. market. In sum, under the special legal mechanism with certain regulatory requirements, the issuer can sell restricted securities in the specific trading market without complying with the information disclosure obligation because the special trading markets established by Rule 144A and Regulation S are not considered to be the U.S. market.

Overall, in order to protect domestic investors, the current legal structure properly distinguishes the non-U.S. market from the U.S. market. By enacting a series of meticulous rules, the regulator creates more possibilities for issuers conducting fundraising by reinforcing several special channels of trading markets,

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<sup>440</sup> Technically, Rule 144 is a rule that concerns “transforming” restricted securities into non-restricted securities. After the requirements of Rule 144 are fulfilled, restricted securities are no longer restricted, so that the securities can be sold out from the specific trading market to the public trading market. Nevertheless, Rule 144 accelerated the enactment of the following rules of resale exemption that the regulator intends to facilitate the efficiency of fundraising.

which are not in the scope of the U.S. market. Since securities transactions in those specific channels do not affect the interests of domestic investors, the issuer does not have to follow the same U.S. disclosure obligation as those trading in the U.S. market. To ensure that it does not interfere with the interests of domestic investors, the issuer must fulfill regulatory requirements in utilizing those specific channels. The specific channels of trading markets provide the issuer with great efficiency for fundraising even though the issuer has to fulfill those requirements in a complicated fashion.

## **B. Relaxed Regulatory Standard for the Nationality of the Foreign Issuer**

The legislators carefully define the U.S. market and non-U.S. market, and then impose an information disclosure obligation upon the issuer when the issuer conducts securities issuance in the U.S. market. Certainly, when issuing securities in the U.S. market, whether it is a U.S. issuer or a non-U.S. issuer, the issuer has to follow the obligation of information disclosure. However, the regulator sets up a lenient regulatory standard for the foreign issuer in order to facilitate fundraising. In other words, even though the foreign issuer has to follow the same legal obligation as the domestic issuer when issuing securities in the U.S. market, the foreign issuer enjoys a different system of disclosure, which increases their effectiveness and efficiency of fundraising. From the perspective of attracting foreign issuers to the domestic market, we considered this a beneficial approach.



Since different country have different business customs, it is a great waste of money to require foreign issuers to follow exactly the same standard as the domestic issuers do.<sup>441</sup>

As we discover, an issuer who is considered a Foreign Private Issuer may use Form F-1 and Form 20-F for securities registration and ongoing information reporting while performing securities offering and sale as well as listing and trading. A Foreign Private Issuer must disclose basically the same information as the domestic issuer; however, the advantage of using Form F-1 and Form 20-F is that the foreign issuer may submit a more concise disclosure content without revealing unnecessary detailed trivia. Since regulatory compliance is a tedious process, the lenient standard is favorable for the foreign issuer because it saves time and cost.

In addition, the regulator provides several exemptions for the foreign issuer when it comes to offering information, as long as the issuer is considered as a qualified “foreign issuer”. For example, under Section 12(g) of the Exchange Act, the reach of certain number of investors results in the issuer’s information disclosure in the secondary market, even if the issuer does not really list on any domestic securities exchange. The rationale behind Section 12(g) may come from the idea of investor protection, considering that an issuer with such a business scale would influence the interests of investors in the public market. Nevertheless, if the issuer primarily lists in the foreign exchange, the issuer is exempted from

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<sup>441</sup> See Demmo, *supra* note 16, at 715.

securities registration pursuant to Rule 12g3-2(a) because the issuer is considered a “foreign issuer”.<sup>442</sup> On top of that, the regulator exempts a Foreign Private Issuer from providing several items of on-going information disclosure. For example, Form 20-F gives an FPI flexibility so that the FPI can submit financial statements in a longer time interval; additionally, an FPI may adopt IFRS as the basis of the financial report. When it comes to corporate governance member installment and internal control, the FPI is exempt from almost all requirements, considering the diversity of different corporate governance cultures of businesses around the world. The Sarbanes-Oxley Act requires only the establishment of an audit committee for the FPI.<sup>443</sup>

Regarding the listing standards of securities exchanges, the foreign issuer must follow the same quantitative standard as the domestic issuer. It is understandable to impose the same quantitative standard because a company must be capable of listing on exchanges whether the issuer is domestic or foreign. However, when it comes to the corporate governance requirement, the foreign issuer may follow the standard of its own country under the exchange rules. This direction is consistent with the regulatory attitude that the regulator exempts the FPI from almost all of the installment and internal control requirements.

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<sup>442</sup> See Fox, *supra* note 138, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, at 2615.

<sup>443</sup> See the discussion in Chapter 2 about the standard for the FPI on corporate governance requirements.

## **(2) Future Path of U.S. Regulations**

From the perspective of investor protection, current regulation raises the question of whether or not the regulator should impose a uniform standard on the foreign issuer. For the current U.S. situation, imposing a uniform regulatory standard may be very unfavorable because the foreign issuer will feel sensitive to this change.<sup>444</sup> If the foreign issuer cannot take advantage of the relaxed regulatory standard, they will rethink entering the U.S. market, since the U.S. has some of the most demanding disclosure requirements in the world. In that case, the U.S. would lose its competitive strategy of attracting foreign issuers. Hence, rendering the regulator—the SEC—with discretion to set up a lenient standard for foreign issuers maintains the competitive advantage. Even though the relaxed regulatory standard offers the foreign issuer great convenience and efficiency, the current regulation still requires the foreign issuer to follow the primary obligation of information disclosure that does not contradict the legal structure of strictly defining the domestic and the foreign market. In other words, the regulator does not give up regulating the foreign issuers, but applies different standards.

When it comes to applying a consistent regulatory standard among the domestic and the foreign issuer, the bonding hypothesis, which reinforces the ground of investor protection, may be a good argument to use in applying a

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<sup>444</sup> See Fox, *supra* note 138, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, at 2621.

unanimous strict standard between the U.S. and non-U.S. issuers. U.S. regulators may consider attracting non-U.S. issuers by lifting instead of dropping the regulatory standard if they adhere to the bonding hypothesis: the main motivation behind an issuer's cross-listing is to bond with a stricter regulatory regime in order improve its corporate governance. Namely, the bonding hypothesis gives the regulator a justified excuse to lift the regulatory standard. However, this dissertation believes that the current U.S. regulatory structure can reach the bonding effect to some extent even with inconsistent standards, since it does not prohibit non-U.S. issuers from selecting the same strict regulatory standard that applies to the U.S. issuer. Although relevant U.S. corporate governance rules do not mandatorily apply to the foreign issuer, if they wish, the foreign issuer may choose the same standard as the U.S. issuer does.

As a result, this dissertation believes a more realistic approach for the future regulatory development would be maintaining the current legal and regulatory structure that defines a fine line between the domestic and foreign market as well as giving the SEC flexibility to offer the foreign issuer regulatory favors. The SEC is entitled to adjust its regulatory policy by amending rules based on the legislative framework idea of investor protection under the Securities Act of 1933 and the Securities Exchange Act of 1934. The regulatory policy may choose to relax the regulatory standard on the foreign even more than the current standard, or as strict as the regulatory standard, on the domestic standard. Admittedly, from the perspective of attracting more issuers, allowing the world-class foreign issuer to list in the U.S. market without following U.S. regulatory requirements will increase competition in the U.S. market. However, the mere condition of the quantitative

qualification is not a justified reason to give up the basic principle of requiring information disclosure when conducting securities transactions in the U.S. market. The foreign issuer should follow the U.S. disclosure obligation when conducting securities transactions even if issuers are world-class companies. Otherwise, the regulator should define a free trade offshore zone of a sub-market where issuers—regardless of whether they are foreign or domestic—are not required to follow the U.S. disclosure obligation. That way, the concern of investor protection in the U.S. market is resolved.

Since the regulatory cost of setting up a free trade offshore zone may be tremendous, the SEC may consider adopting the idea of creating different standards among foreign issuers by defining the minimum required protection for domestic investors. The regulator first divides foreign issuers into two groups: 1) the group issuers who come from low regulation regimes and 2) the group of issuers who come from high regulation regime that reaches the threshold of the minimum required U.S. investor protection. The regulator then imposes U.S. regulatory obligations upon issuers from low regulation regimes, while the issuers from high regulation regimes are exempt from U.S. regulatory obligations because they are already substantially regulated by their own country's standards. This approach maintains domestic investor protection as well as efficiency and effectiveness of fundraising for foreign issuers.

Commentators may argue that this approach of defining the minimum required protection for the domestic investors favors the interests of U.S. investors rather than any of the interests of foreign issuers. Nevertheless, it is

understandable that different jurisdictions put emphasis on the priority of their own interests. Under the premise of sovereignty integrity maintenance, each jurisdiction has the power to choose what is best for its own people.

### **(3) Alternative Regulatory Directions via Reforming from the**

#### **Outside of Regulatory Structure**

Several approaches offer alternatives for reforming the regulatory direction by replacing the current regulatory structure rather than merely correcting the current defects. As mentioned before, the U.S. can improve international securities regulation through regulatory competition or regulatory cooperation. Yet from the economic perspective, regulations should increase the best social welfare by imposing mandatory regulation on the domestic issuer.

The U.S. is unlikely to adopt a policy of regulatory competition that allows the issuer to choose its preference of regulatory regime. Even though the idea of regulatory regimes competing with each other due to capital movement poses a good argument, several factors discourage the U.S. regulator from adopting issuer choice. Certainly, the adoption of the internal affairs doctrine brought about the positive effect that many states removed outdated and inefficient laws due to the charter competition of the 19th century. However, the successful experience of charter competition may not compare to international securities regulation due to the diversity of business customs and the regulatory tendencies of different nations around the world. A very common debate involves the controversy of

whether issuer choice always leads to a race-to-the-top or a race-to-the-bottom scenario.

On the other hand, regulatory cooperation or harmonization may be a long-term effort for regulators among different regimes. Depending on the effort of regulatory cooperation with other jurisdictions, the influence of harmonization may not be very significant because every jurisdiction or country has its own interest. Currently, the U.S. and Canada have developed the MJDS agreement for mutually recognizing each country's regulations. However, it is relatively easy for the U.S. and Canada to reach a consensus because the regulations between these two countries are similar enough that it is not necessary to repeatedly fulfill each other's similar regulatory requirements. When facing a very different regulatory system, on the other hand, it may be hard to reach harmonization or reconciliation. For instance, as previously mentioned, it took Germany many years to negotiate with the U.S. for the recognition of the European IFRS accounting standard after U.S. GAAP was the dominant and only accepted standard.<sup>445</sup> Often, the country with the stronger political power will force other parties to accept its regulatory framework or standard.<sup>446</sup> Critics believe that IOSCO's proposals to harmonize the disclosure standard often turns out to be relying on current U.S. requirements.<sup>447</sup>

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<sup>445</sup> See SCOTT ET AL., *supra* note 59, at 39.

<sup>446</sup> *Id.*

<sup>447</sup> *Id.*

Last but not least, this dissertation believes that it may be a novel idea to impose mandatory regulation on U.S. issuers without imposing this same standard on the foreign issuer. The idea of mandatory regulation on the U.S. issuer proposed by the scholar from the economic analysis seems to have very strong arguments without solid rebuttals. Admittedly, investor protection may not be the focus of mandatory disclosure from the economic analysis. However, the regulator should establish a strong securities market index to facilitate the market order and increase investor confidence. Professor Fox argues that the cost of information disclosure does not reflect the actual value of securities under the efficient market hypothesis, even if the share price may be inaccurate.<sup>448</sup> Hence, there is no problem if the regulator does not impose a domestic mandatory disclosure regime on the foreign issuer.<sup>449</sup> However, investors will discount the securities if the issuer does not disclose information.<sup>450</sup> Investors tend to believe they are being cheated if there is not proper information disclosure.<sup>451</sup> If there is not enough information disclosure, a sound and reliable transaction mechanism of market cannot be established. In addition, imposing a good quality law on foreign issuers undeniably increases a bonding effect that brings about a good reputation for the market, attracts the volume of cross-listing, and increases investor confidence. Should the U.S. take the proposal of imposing mandatory regulation only on U.S. issuers, the current regulatory structure would be overthrown.

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<sup>448</sup> See the discussion in *supra* note 164.

<sup>449</sup> *Id.*

<sup>450</sup> *Id.*

<sup>451</sup> *Id.*



## **2. Analysis of Taiwanese Regulations**

### **(1) Similar Characteristics to U.S. Regulations**

The amendment of the Securities and Exchange Act expressly includes the idea of foreign issuers conducting fundraising under the regulatory scope, indicating that the current regulatory attitude of Taiwan follows the same idea of emphasizing protection for domestic investors as the current U.S. regulatory direction does. The legislative amendment also contributes to equal treatment between the domestic and foreign issuer. The goal is to define a scope of the domestic market, considering that issuers, whether domestic or foreign, have to comply with the relevant Taiwan regulations, especially the disclosure obligation pursuant to the Securities and Exchange Act. Under the framework of investor protection in the Taiwanese market, the legislators also treat the foreign issuer with a different regulatory standard so that the foreign issuer can accelerate fundraising efficiency under a more lenient standard.

### **(2) The Different Parts**

#### **A. Unique Legislative Technique**

U.S. legislators adopt a unique legislative technique in how it decides the regulatory direction and then authorizes the regulator to amend relevant rules of

safe harbor for adoption by foreign issuers. Specifically, for example, the issuer performing securities transactions in the U.S. market is required to meet immediate and ongoing disclosure obligations under the Securities Act of 1933 and the Securities Exchange Act of 1934. The regulator—i.e., the SEC—is authorized to enact a different standard to simplify or waive the FPI’s obligation under the framework of the Securities Act of 1933 and the Securities Exchange Act of 1934.

By comparison, Taiwanese legislators adopt the approach of completely or partially imposing the same articles of regulatory obligations on the foreign issuer as they do on the domestic issuer, depending on the nature of the obligations. For example, while the corporate governance requirements imposed on the domestic issuer also apply to the primary listing issuer, the secondary listing issuer is not required to follow the relevant corporate governance requirements and thus does not need to follow the relevant obligations from article 14-1 to article 14-5.

However, in cases where the same kind of regulatory obligations apply to both the domestic and the foreign issuers, the regulator is authorized to enact different regulatory standards for domestic and foreign issuers. For example, in the immediate disclosure obligation, both the domestic issuer and the foreign issuer are unanimously required to comply with the securities registration requirement in the issuance of securities in Taiwan because information disclosure is necessary in the domestic market from the perspective of domestic investor protection. But in disclosing the particulars on the prospectus, the

regulator makes different standards for the domestic issuer and the foreign issuer respectively.<sup>452</sup>

## **B. Further Distinctions Between the Primary Listing Issuer and the Secondary Listing Issuer**

Compared to the U.S., the most distinctive characteristic when it comes to listing in Taiwan is that foreign issuers are further distinguished into the categories of primary listing foreign issuer and secondary listing foreign issuer, and thus must follow different standards respectively. In the U.S., however, the regulator does not divide the foreign issuer into the primary listing issuer and secondary listing issuer. The FPI in the U.S. is entitled to enjoy a relaxed standard. In Taiwan, the current distinction depends on whether the issuer has previously listed in another jurisdiction. We find that although the standard on primary listing issuers is slightly looser than the standard on domestic issuers, in many ways, primary listing issuers must apply *mutatis mutandis* to the same requirements as the domestic issuer.

Therefore, the Taiwanese regulator's treatment of the primary listing foreign issuer is more demanding than the way the U.S. regulator treats the FPI, whereas the Taiwanese regulator's treatment of the secondary listing issuer is

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<sup>452</sup> See Table 12 in Chapter 4 of this dissertation: The standard on the primary issuer is more relaxed than the standard on the domestic issuer. The standard on the secondary issuer is even more relaxed than the standard on the primary issuer.

more relaxed than the way the U.S. regulator treats the FPI. Perhaps there are advantages to the current Taiwanese regulatory arrangement. This way, by requiring the primary listing issuer to follow the domestic regulatory standard, the Taiwanese regulator will substantially improve the level of domestic investor protection. The secondary listing issuer who complies with the listing regulations under another jurisdiction does not have to comply with the tedious procedure of the high disclosure regulatory standard again, and thus accelerates the convenience of fundraising.

However, this dissertation believes that the current approach of distinction may result in regulatory arbitrage to some extent. Specifically, it may encourage the foreign issuer to first list in a loose regulatory regime, such as the emerging market or in a civil law system jurisdiction that has weak shareholder protection, before listing in Taiwan. As a result, this dissertation suggests that we should define a minimum threshold of investor protection as the basis for the regulation on the secondary listing issuer.<sup>453</sup> The secondary listing issuer should further divide into two groups: 1) issuers from regulatory regimes that meet or exceed the minimum threshold of investor protection, and 2) issuers from the regulatory regimes that do not meet this threshold. Issuers from the above-threshold regulatory regimes may continue complying with the regulatory regimes, and are not required to reconcile with the current Taiwan disclosure regulation; by contrast, those companies from the below-threshold regulatory regimes must

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<sup>453</sup> As Professor Davidoff suggests. *See* Davidoff, *supra* note 30, at 160.

follow the current Taiwan disclosure regulations in order to ensure the protection of domestic investors.

If the Taiwanese regulatory structure chooses to keep the current classification, at least it should correct the defects in the current exchange listing standards. Current quantitative listing standards are confusing and inconsistent with the original legislative rationale and regulatory direction. We can discover that in some particulars, the standard on the secondary listing company is higher than the standard on the primary listing issuer, whereas in other cases, the standard on the secondary listing company turns out to be the same as the standard on the primary listing issuer. This is inconsistent with the regulatory direction that requires the standard on the primary listing issuer to be higher than the standard on the secondary listing issuer.

### **C. Regulatory Structure of Information Disclosure**

Information disclosure is the method of reaching investor protection from the perspective of defining the scope of the domestic market. The framework of the current Taiwan information disclosure regulation is similar to the U.S. framework, whereas the regulatory structures between these jurisdictions are not identical.

Regarding the immediate disclosure information obligation, there is only a one-time securities registration requirement when the issuer conducts the public offering of securities. There is no registration requirement when listing and

trading on a securities exchange. The one-time registration requirement saves the issuer from additional costs over the course of securities issuance.

As for the ongoing disclosure requirement under U.S. law, three different events—including securities exchange listing, issuer's market size, and issuer's securities public offering—trigger the issuer to become a reporting company that is obligated to continuously provide information to the public. By contrast, in Taiwan, becoming a public company is a prerequisite of conducting securities public offering. The issuer has to first register as a public company and then decide whether to conduct securities offering publicly. Once the issuer becomes a public company, it is obligated to provide current and ongoing information just like the reporting company under the U.S. Securities Exchange Act. However, under the Taiwanese regulatory structure, once the issuer has obtained public company status, it must make information disclosure on a continuous basis even if the issuer does not conduct securities offering publicly later on. From time to time, we see there are “public companies” who do not publicly conduct any securities offering after the issuer acquires the legal status of the public company. Therefore, the reporting obligation under the current Taiwanese regulatory structure in fact poses an unnecessary burden on the issuer.

The flaw of the information disclosure obligation is that the law does not properly impose this obligation on the issuer when the issuer conducts securities issuance. Perhaps the legislators intend to make the regulator obtain a good understanding of the issuer's business performance before they determine the issuer to be capable of conducting securities issuance. What is even more

inconvenient for the issuer is that the issuer also has to obtain the public company status before conducting private placement to specific sophisticated investors. Pursuant to the current Securities and Exchange Act, a public company may choose to sell securities by way of private placement, which means that current Taiwanese regulation prohibits non-public companies conducting private placement. In the U.S., via the mechanism of private placement, an issuer may avoid the burdensome disclosure obligation for both immediate and on-going information disclosure, as long as the issuer does not reach any one of the three statutory provisions that trigger the reporting obligation. By contrast, under the current Taiwanese regulatory structure, an issuer planning to conduct private placement cannot avoid the on-going information disclosure obligation. Specifically, a non-public company can conduct a “non-public sale” of securities to its original shareholders, and a non-public company can even sell its corporate bond through private placement pursuant to the current Company Act, but pursuant to the Securities and Exchange Act, a non-public company cannot use the mechanism of “private placement” to sell its securities to certain sophisticated investors—otherwise, the sale would qualify as a public offering. Therefore, fundraising alternatives for a non-public company are very limited.

#### **D. Accessibility of Special Channels for Fundraising**

The law developed the special channels of trading markets through private placements and a series of resale exemptions to avoid falling into the world of securities issuance in the domestic public market where the issuer has to fulfill

information disclosure obligations. In other words, the foreign issuer can use these special channels of trading markets to increase the efficiency of fundraising. The more channels issuers can access, the more favorable the regulations and effectiveness for the foreign issuer conducting fundraising.

Under the U.S. regulatory structure, rules regarding private placement and a series of resale exemptions are well established. The issuer can initiate these special channels of trading markets by opening up with private placement sale. The issuer may choose one of several ways to accelerate fundraising in cooperation with the initial purchaser in order to transfer restricted securities on special channels. For example, the issuer may request the initial purchaser to resell their restricted securities to the public according to the dribble-out rule—Rule 144, the initial purchaser may choose to conduct private resale to sophisticated investors with a Section 4 (a)(1 1/2) exemption or to QIB under Rule 144A, and finally, issuers may follow Regulation S to sell the securities to the “foreign market”. The issuer may flexibly combine Regulation S and Rule 144A so that the initial purchaser may resell the securities back to the QIB, which is still considered to be within the scope of the “foreign market”.

In Taiwan, the special channels of trading markets available to issuers are relatively limited. Only public companies can access the private placement mechanism; non-public companies without ongoing information disclosure may not take advantage of private placement. This is inconvenient for the issuer who hopes to avoid undertaking the obligation of ongoing information disclosure.



Additionally, the law prohibits secondary listing foreign issuers from conducting private placement with either issuing stocks or Taiwan Depositary Receipts (“TDR”) because the current Securities and Exchange Act does not allow the secondary listing issuer to apply *mutatis mutandis* to the relevant private placement regulation. It is not clear why the legislators do not allow the secondary listing issuer to enjoy the advantage of trading restricted securities in special channels through private placement; perhaps there is some kind of policy concern for the regulator. In any case, the regulation on the secondary listing issuer is more restrictive in Taiwan, which means that the secondary listing issuer cannot enjoy the fundraising advantages enjoyed by the primary listing issuer. In the U.S., ADR listing issuers can trade their securities in PORTAL via the combination of private placement and Rule 144A. In Taiwan, since the secondary listing issuer cannot conduct private placement, such a fundraising alternative does not exist. As a result, under the current framework, the regulations on the foreign issuer are more restrictive compared to the U.S. system.

Furthermore, the special channels of trading markets by way of resale exemptions are relatively fewer. Once the issuer opens the door to the special channels via private placement, the initial purchaser can only choose one of two approaches to transfer restricted securities: The initial purchaser can either transfer securities to the public (subject to volume and holding period restrictions as listed in subparagraph 2 of paragraph 1 of Article 22-2), or they can conduct private resale to accredited investors (following the rules outlined in subparagraph 3 of paragraph 1 of Article 22-2 or Subparagraph 1 and Subparagraph 2 of paragraph 1 of Article 43-8, similar to the Section 4(a)(1 1/2)

exemption in the current U.S. regulatory system). There is no statutory provision or regulatory safe harbor when it comes to reselling to any QIB, because there is not a QIB system established. The current approach of resale exemptions may not be fast enough compared to the fundraising speed of reselling restricted securities to QIBs.

Moreover, the current resale exemptions are flawed. First, lawmakers should delete the registration requirement under the resale to the public exemption because the requirements of volume restriction and holding periods render the immediate disclosure obligation unnecessary. Moreover, lawmakers should remove the additional volume restriction and holding period requirements in the private resale regulation because the private resale follows the relevant requirement of private placement. The subsequent purchasers under statutory provisions are capable of protecting themselves, so the additional requirements are unnecessary under the original private placement regulatory structure. Besides, the law requires the volume and holding period restrictions in order to transform restricted securities into non-restricted securities. In the special channel that allows issuers to freely trade restricted securities via private placement, such requirements are unnecessary. Therefore, the law should immediately allow securities holders to transfer the securities to those subsequent purchasers.

Moreover, the issuer does not have an opportunity to access the special channel to transfer restricted securities under the regulatory assumed offshore market. With Regulation S, U.S. the regulator has made safe harbors to consider

certain securities transactions as trading in the offshore market, thus exempting the securities from registration. Regulation S can even be used in combination with Rule 144A. Without similar safe harbors and rules such as Regulation S and Rule 144A, the issuer loses a great opportunity to increase the efficiency and effectiveness of fundraising.

### **(3) Alternative Regulatory Directions**

#### **A. Discussing Reformation from the Perspective of Regulatory**

#### **Competition**

In recent years, some Taiwanese scholars have argued in favor of amending the regulations to a more relaxed level because they believe the current law is too restrictive. Advocates discuss the idea of jurisdiction competition or regulatory competition, suggesting that the de-listing phenomenon in recent years is a signal from issuers demonstrating the “exit” right and “voice” right to leave the Taiwanese market, and legislators should amend the law by eliminating unnecessary regulatory restrictions in order to increase market competition.<sup>454</sup> However, the suggested reformation from the perspective of regulatory

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<sup>454</sup> See Tsai, *supra* note 9, at 1-12. Professor Tsai uses Albert Hirschman’s theory regarding options of exit and voice to analyze the delisting effect in the Taiwanese market, suggesting that issuers are able to move from an over-regulated jurisdiction to a loose-regulated regime by exercising the “exit right” to evade the high cost of complying with improper regulation due to globalization. Whenever there is a moving-out effect in one jurisdiction, the anti-regulatory issuers and the exit-affected issuers will work together to compete with the pro-regulatory issuers as well as exercising the “voice right” to pressure the government to reform the law and stop inefficient regulation. Afterwards, the law will substantially improve. In other words, the capability of capital mobility results in the phenomenon of regulatory competition that leads to the regulatory reformation. Regarding Professor Hirschman’s theory, see HIRSCHMAN, *supra* note 82.

competition raises a fierce debate of whether this would result in a race-to-the-top or race-to-the-bottom effect.

On the one hand, if we lower the current regulatory standard for foreign issuers, we will create a race-to-the-bottom situation through sacrificing the interests of domestic investors. In fact, scholars indicate the legal transparent of the current regulation falls behind Hong Kong and Singapore, yet these two countries have a higher number of foreign listings compared to Taiwan.<sup>455</sup> In addition, legislators have removed many administrative and procedural restrictions on the fundraising of the foreign issuer in recent years.<sup>456</sup> Thus, it seems there is no justified reason to lower the regulatory standard.

On the other hand, commentators suggest raising the quality of Taiwanese law by lifting the regulations to international standards or the standards of regional competitors such as Hong Kong and Singapore in an attempt to race to

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<sup>455</sup> Wang and Chen, *supra* note 3 at 280.

<sup>456</sup> For example, the Regulations Governing the Offering and Issuance of Securities by Foreign Issuers Article 7 was modified in August 14, 2008, eliminating the restriction on funds raised in Taiwan that would be used on the investment in mainland China. The content of the past article was:

“The FSC may reject an offering and issuance of securities if any of the following circumstances exist: ...the offering and issuance registered involves the raising of funds, and is accompanied by either of the following circumstances: (1) the funds raised will be invested directly or indirectly in mainland China; or (2) the cumulative amount invested by the Foreign Issuer directly or indirectly in mainland China exceeds 40 percent both of its net worth and of the additional amount of its investment within the Republic of China in the coming fiscal year, provided that this provision shall not apply where the funds to be raised through the current offering and issuance will be used to acquire fixed assets within the Republic of China (Taiwan).”

the top.<sup>457</sup> Nevertheless, it is questionable whether this will prevent issuers from listing, since a high regulatory standard indicates a high cost of legal compliance. Besides, it will take further examination to analyze the overall distinctions among the legal systems of Taiwan and other different regimes that are worth emulating.<sup>458</sup>

As a matter of fact, regulatory competition, which is one of the proposed theories of international securities regulation, is supposed to analyze the general fundraising law – securities law, focuses on whether the information disclosure standard is too high, or leads to a barrier on the foreign issuer.<sup>459</sup> There is sufficient reason to suggest eliminating unnecessary regulatory restrictions if we find that the current regulatory standard of information disclosure is too high. However, from the available research on the current securities regulatory structure, the disclosure standard on the foreign issuer is not as high as the disclosure standard on the domestic issuer.

This dissertation believes relevant studies merely cover the special restriction analysis rather than comparing securities regulatory standards between the domestic and the foreign issuer. In addition, the compliance cost of overall regulations in Taiwan is the lowest compared to the costs in Hong Kong

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<sup>457</sup> Wang and Chen, *supra* note 3, at 281.

<sup>458</sup> *Id.*

<sup>459</sup> The theories of international securities regulation all focus on information disclosure standards, which are the essence of regulation on the securities market. *See* the discussion on Chapter 2.

and the U.S., according to the scholarly research.<sup>460</sup> Thus, the current regulatory standard on the foreign issuer should not be the primary factor if or when an issuer delists from the Taiwanese market. As a result, it seems there is no sufficient argument to suggest relaxing the regulatory standard on the foreign issuer under the general fundraising law.

## **B. Regulatory Cooperation May Be a Supporting Method to Reach Regional Development**

The advantage of regulatory cooperation is the low cost of regulatory compliance. However, the reach of regulatory cooperation may often be a political issue since the party with stronger political power will force another party to accept its regulatory framework, standards, or requirements in the course of negotiation. Therefore, regulatory cooperation may be a long-term effort and a supporting to method to improve regulatory efficiency depending on the process of international negotiation.

Different jurisdictions usually use regulatory cooperation to reach regional development. There have been substantial cases in the Cross-Strait relations recently. The FSC has cited three memorandums of understanding, with Chinese banking, securities, and insurance regulators respectively, for the basis of a close supervision cooperation.<sup>461</sup> In order to attract more Chinese investing issuers for

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<sup>460</sup> See Tsai, *supra* note 9, at 90-91.

<sup>461</sup> Wang and Chen, *supra* note 3 at 24.

listing, we expect to reach mutual recognition and harmonization in the long term. However, due to the complicated Cross-Strait issue of compromising sovereignty, scholars suggest that cooperation between stock exchanges will be a significant approach to avoid the political dilemma, as well as reaching regional development.<sup>462</sup>

### **C. Mandatory Regulations on the Domestic Issuer without the Foreign Issuer May Be a Far Fetched Approach under the Current Regulatory Philosophy**

The argument for imposing mandatory regulation on the domestic issuer but not the foreign issuer may be persuasive. However, the current Taiwanese regulatory structure focuses on investor protection, which is consistent with the current regulatory direction for the U.S. Therefore, it is not proper to smash the current regulatory structure, as rebuilding a new regulatory structure is costly. Nevertheless, mandatory regulation on only the domestic issuers may be preserved as an alternative for the future regulatory policy when the relevant evidences of empirical research become more mature.

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<sup>462</sup> *Id.* at 25.

## **II. Drawbacks of the Current Taiwanese Regulatory Structure**

Even though the current Taiwanese regulatory policy essentially develops in the same direction as U.S. regulation, there are several drawbacks compared with U.S. regulation. The drawbacks divide into several categories.

### **1. Issues in Distinguishing between the Primary Listing Company and the Secondary Listing Company**

According to U.S. regulation, the foreign private issuer files Form F-1 and Form 20-F for securities registration. Even though ADR issuers file Form F-6 for securities issuance, the Level three ADR issuer also files Form F-1. Hence, the U.S. does not distinguish between primary listing issuers and secondary listing issuers. In other words, the U.S. requires all foreign issuers to follow the same standard regardless whether the issuer has previously issued an information disclosure.<sup>463</sup>

In Taiwan, disclosure standards on the foreign issuer further divide into the standards imposed on the primary listing issuer and those imposed on the secondary listing issuer. Some may suggest that the disclosure standards between the primary listing issuer and secondary listing issuer should be consistent in order to avoid confusion; more importantly, they state that a consistent regulatory

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<sup>463</sup> In addition, even though the listing rule of Hong Kong Exchange distinguishes primary listing issuer and secondary listing issuer, the disclosure standards are not all that different. Singapore Exchange also does not distinguish the standards for the primary listing issuer and secondary listing issuer. *See Wu, supra* note 6, at 153-54.



standard prevents the secondary listing issuer from evading the law. After all, it may be not so persuasive to state that the foreign issuer can enjoy exemption from the Taiwanese disclosure regulation only because it has made information disclosure previously in another jurisdiction.

However, from the perspective of investor protection, this dissertation believes that it is an acceptable approach to save the issuer from double fulfillment of the disclosure process on the premise if the issuer has received effective supervision in accordance with a high quality regulation. Whether or not we should require the secondary listing issuer to comply with the Taiwanese disclosure standard relies on whether or not the disclosure standard that the issuer already follows is comparable to the Taiwanese disclosure standard of investor protection. Therefore, lawmakers should establish a minimum threshold of investor protection to evaluate whether the secondary listing issuer should be required to follow the Taiwanese disclosure standard.

Currently, since we have made a distinction between the primary listing issuer and the secondary listing issuer, the relevant rules should follow the rationale behind the distinction. The regulatory standard for the primary listing issuer should closely match the standard for the domestic company because the primary listing issuer has not experienced the same level of regulation before. The secondary listing issuer, by contrast, may follow the standards of the jurisdiction in which they previously listed. As a result, the regulatory standard on the primary listing issuer is supposed to be higher than the regulatory standard on the secondary listing issuer. Unfortunately, we find that the listing standards of the

securities exchanges do not really follow this regulatory principle. For example, as with some other quantitative standards, the standard on the secondary listing issuer is higher than the standard on the primary listing issuer. Therefore, relevant listing standards on securities exchanges are confusing and, thus lawmakers should correct them.

## **2. Insufficient Parts under the Information Disclosure Structure**

Currently in Taiwan, issuers must only follow a one-time securities registration obligation when conducting securities offering. This seems more relaxed compared to U.S. securities regulation, which imposes double the registration obligations when conducting securities offering and sale in the issuance market as well as listing and trading in the trading market.

However, the requirement of the ongoing information disclosure obligation as the prerequisite condition of securities public offering is burdensome because the issuer has to provide ongoing information even if the issuer does not really issue securities. Even worse, current securities regulation requires an issuer to become a public company as the prerequisite condition of conducting private placement. Therefore, it is inconvenient for the private placement issuer to also fulfill the obligation of providing ongoing information because such an obligation is supposed to be imposed only on the public offering issuer.

The insufficiency of the special channels of trading markets to facilitate the fundraising efforts of foreign issuers is another downside of the regulatory structure when it comes to information disclosure. As previously mentioned, the regulatory requirement regarding private placement does not apply to non-public companies who do not have to fulfill the ongoing information disclosure obligation. The secondary listing issuer may not take advantage of the benefits of private placement. Moreover, the resale exemptions that facilitate special channels of trading markets are relatively few. Without other useful tools in regulatory design such as Rule 144A or Regulation S or a combination thereof, the chance of increasing fundraising volume is relatively limited.

Additionally, since relevant regulatory requirements emulate U.S. law, lawmakers need to correct several flaws in the elements of the resale exemptions in accordance with the rationale of the original U.S. rules; otherwise, the regulatory requirements are not complete.

### **3. The Absence of Reinforcing Investor Protection as the Regulatory Direction**

This dissertation previously listed some proposed alternatives for regulatory reformation; however, these alternatives may not be ideal for the future path of Taiwan, as this dissertation believes that the advantages of reinforcing the idea of investor protection outweighs the disadvantages of other alternatives. Since many

suggestions for regulatory reformation involve different ideas such as regulatory competition or regulatory cooperation, we often ignore the idea of investor protection. Therefore, this dissertation argues that we should reinforce investor protection as the regulatory direction for future reformation.

Under the premise of investor protection, the law should recognize a threshold of minimum investor protection, while it is not appropriate to relax the disclosure standard for the foreign issuer. Additionally, maintaining a high quality of law creates a bonding effect that attracts issuers entering the domestic market for listing in order to increase the level of corporate governance. Once the bonding effect is established, it will not only attract more foreign issuers, but also benefit the investors as the issuers' corporate governance improves. Although there are opposing voices, the advantages of bonding, including increasing a series of external effects, cannot be ignored, especially considering that it will lead to a certain extent of external effects once the law recognizes a minimum investor protection. Specifically, even if different regulatory disclosure standards apply to the domestic issuer and foreign issuer respectively, the market will establish comparability when we adopt the minimum investor protection concept. The minimum investor protection threshold will result in every issuer making or having made information disclosure in accordance with the minimum domestic investor protection, and therefore will ensure every issuer stands on the same level of information disclosure.

### **III. Suggestions for Future Reformation**

Regarding future regulatory reformation, lawmakers should establish a firm regulatory direction and approach. Under a firm regulatory direction, lawmakers will develop a sound regulatory structure, and thus amending and revising the law based on the framework of the regulatory structure. According to the comparative research on the two different regulatory systems and the analysis of the drawbacks of the Taiwanese structure, the suggestions for the future reformation are as follows.

#### **1. Establishing a Minimum Threshold of Investor Protection under the Regulatory Direction of Investor Protection**

The current regulatory structure follows the approach of focusing on domestic investor protection, much like the U.S.'s approach. Following the idea of domestic investor protection, the regulations further divide into two standards for the primary listing issuer and the secondary listing issuer respectively. The current standard on the secondary listing issuer is very relaxed because most of the time, the secondary listing issuer can follow the disclosure standard of the regime in which it previously listed, rather than complying with the Taiwanese standard. Hence, the investor protection may not be good enough. In order to ensure domestic investors receive sufficient protection, this dissertation suggests that the law should establish a minimum threshold of investor protection, in which secondary listing issuers must comply with the Taiwanese disclosure

standard if the issuer comes from a regulatory regime in which the disclosure standard falls below the minimum threshold of Taiwanese investor protection. By contrast, the law should not require the secondary listing issuer to comply with the Taiwanese disclosure standard if the issuer comes from a regulatory regime in which the disclosure standard exceeds the minimum threshold of Taiwanese investor protection.

Practically speaking, this dissertation suggests further distinguishing the secondary listing issuer based on the origin of the listing market on which it previously listed. In the main board of the overseas securities markets approved by the FSC, some markets belong to the “developed markets”, while others are “emerging markets”.<sup>464</sup> Usually, the developed markets tend to have a stricter standard of disclosure requirements, whereas the emerging markets have a lower standard of disclosure requirements. Therefore, we do not have to impose upon the issuer who has previously listed on developed markets to fulfill the Taiwanese regulatory standard of disclosure requirements because the issuer has already received a high standard of regulation, which is the same or higher than the Taiwanese standard. The additional imposition of Taiwanese regulation will lead to unnecessary compliance cost, and may discourage issuers from listing. Regarding the issuer who has previously listed on emerging markets with a relatively lower standard of disclosure requirements, they must comply with the Taiwanese standard, in order to provide appropriate investor protection. This

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<sup>464</sup> See Wu, *supra* note 6, at 158.

also increases the listing motivation by providing a chance with the bonding effect.<sup>465</sup>

## **2. The Law Should Revise Listing Standards on the Securities Exchanges by Distinguishing between the Primary Listing Issuer and the Secondary Listing Issuer**

The relevant requirements of exchange standards should follow the regulatory intention under the regulatory design of distinguishing the primary listing issuer and the secondary listing issuer. Specifically, the listing standard imposed on the primary listing issuer should be higher than the listing standard for the secondary listing issuer. However, the requirements on the securities exchanges do not exactly follow this regulatory principle. The quantitative standard requirements for the secondary listing issuer are yet more demanding than the requirements for the primary listing issuer. As a result, the law should revise the relevant requirements of the securities exchange rules.

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<sup>465</sup> *Id.*

### **3. Imposing Ongoing Information Disclosure Obligation in the Correct Timing**

Lawmakers should improve the current regulatory structure, which blocks many convenient opportunities for fundraising, so that the ongoing information disclosure obligation no longer serves as the prerequisite condition of securities public offering, but instead is imposed only when the issuer conducts public offering. That way, issuers will avoid the unnecessary cost of ongoing information disclosure before the issuer conducts securities public offering or if the issuer does not fulfill securities public offering afterwards. Most importantly, this will remove the current improper restriction on the private placement that unreasonably requires the issuer to provide ongoing information disclosure obligation as the prerequisite of private placement.

### **4. Special Channels Facilitating Reformation**

The establishment of special channels of trading markets increases the potential fundraising volume. Hence, lawmakers should remove the restrictions on secondary listing issuers regarding private placement. Therefore, Article 165-2 under the Securities and Exchange Act should also allow the secondary listing issuer to apply *mutatis mutandis* to the relevant regulations of private placement.



In addition, the law should increase the number of resale exemptions that facilitate the special channels of trading markets, as the requirements of the resale exemptions emulate the U.S. regulatory disclosure structure. The difference between the Taiwanese system and the U.S. system is the Taiwanese legislative technique in which the law amends statutory provisions to regulate relevant situations, while the U.S. regulator is authorized to enact several rules of safe harbor to complete and fulfill the disclosure structure. Hence, the development of the special channels of trading markets depends on the amendment of law in Taiwan. Regarding resale exemptions, there is the rule of resale to the public and the rule of private resale, respectively corresponding with Rule 144 and Section 4 (a)(1 1/2) of U.S. law. In the future, this dissertation suggests that Taiwanese law emulate the U.S. regulatory designs such as Rule 144A and Regulation S in order to complete the regulatory structure of information disclosure and facilitate fundraising accessibility.

## **5. Revising the Requirements on the Current Rules of Special Channels**

Even if there are exemptions for resale to the public and private resale, flaws still exist in the current regulation. The law should revise the rules of resale exemptions in accordance with the rationale of the original U.S. resale exemptions, including Rule 144 and Section 4 (a)(1 1/2). The law should remove the registration requirement on the reseller since the requirements of volume restriction and holding period give justified reasons for this exemption. Besides,

the additional requirements of volume restriction and holding period on private resale are unnecessary because private resale follows the rule of private placement, which does not include the volume restriction or holding period requirements.

## **6. Adjusting the Policy on Foreign Issuers under the Premise of Minimum Investor Protection**

After studying the regulatory requirements and standards on the foreign issuer, we can understand that the current regulatory structure provides the foreign issuer with a lenient standard. Therefore, the argument about relaxing the regulatory standard is not persuasive because the regulatory standard of information disclosure along with other relevant obligations does not cause listing difficulty. Thus, we should abandon the idea of relaxing the disclosure standard for the foreign issuer. However, even though we offer the foreign issuer convenience, investor protection is still the primary goal under the current regulatory direction. Investor protection should be realized through establishing a threshold of minimum investor protection.

## **Chapter 6: Conclusion**

The phenomenon of issuers delisting from the Taiwanese market in the 2000s includes various factors. Many studies attribute the delisting phenomenon to the Taiwanese government's restriction of the special fundraising law. However, the restriction of the special fundraising law is not the only reason for the delisting phenomenon. Instead, many other factors, such as the economic recession or the regulatory effect of the general fundraising law, could contribute to the delisting phenomenon as well. Admittedly, it is difficult to deal with this issue by looking over all the different perspectives at the same time. However, this dissertation believes it is very beneficial to the issuer's fundraising arrangement and regulatory design to understand the influence of the general fundraising law: securities regulation, because this is a such essential and fundamental area of law in the capital markets, yet rarely received careful examination when discussing the potential legal threshold of entering the Taiwanese market.

This dissertation focuses on the study of the general fundraising law relating to the foreign issuer conducting fundraising in Taiwan, attempting to find out if the regulatory intensity of the general fundraising law on the foreign issuer poses an unfair obstacle to the foreign issuer entering the Taiwanese market. To realize the regulatory intensity on the foreign issuer, one must analyze the regulatory requirements and standards on securities issuers. Originally, this dissertation assumed the general fundraising law imposed on the foreign issuer with a high regulatory standard might have contributed a factor to the phenomenon of

delisting issuers. However, after surveying the current Taiwanese regulation, this dissertation discovered that the regulator instead provides the foreign issuer with a lenient standard, even though the foreign issuer has to comply with most of the same regulatory requirements as the domestic issuer.

As international securities regulation theories develop in U.S. academia, this dissertation considers the study on regulatory theories to be a beneficial methodology that gives us a reference for suggesting an ideal model for regulatory direction. Applying this theoretical analysis to the U.S. regulatory structure, we realize the U.S. follows the traditional view of taking investor protection as the regulatory direction. In comparison, Taiwan's regulation has similar characteristics. Just like the U.S., Taiwan's regulatory structure reflects the value of investor protection because the foreign issuer has to comply with most of the same regulatory requirements as the domestic issuer. Like the U.S. regulator's approach, Taiwan also provides the foreign issuer with a relaxed standard due to the consideration of increasing market competition and the difficulty of legal compliance regarding the entry to a jurisdiction.

However, some imperfections under the current Taiwan regulation may become an obstacle to the foreign issuer entering Taiwan. The problem is not the high regulatory standard on the foreign issuer, but rather the fact that certain flaws exist in both the current regulatory requirements and regulatory standards. In addition to revising the flaws, there might be room for the regulator to reconsider and adjust the regulatory direction in the long term, even though the current regulatory structure basically follows the same model as the U.S. structure.

As a result, this dissertation hopes to provide some suggestions from a legal perspective for future regulatory reformation, offering such ideas as the following: First, the law should amend the different requirements between the primary listing issuers and the secondary listing issuers in accordance with the original regulatory purpose; second, the law should improve the insufficiency under the current information disclosure structure in order to facilitate the accessibility of fundraising; and last but not the least, the law should not allow issuer choice of regulatory regimes, because it does not seem to fit in the current regulatory approach, as the current regulatory direction emphasizes investor protection above all. The regulatory structure is built on the traditional approach of investor protection. Although other approaches, such as issuer choice or mandatory information disclosure on domestic issuers, may also achieve the same effect of investor protections, these approaches contradict the content of the current regulatory structure.

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